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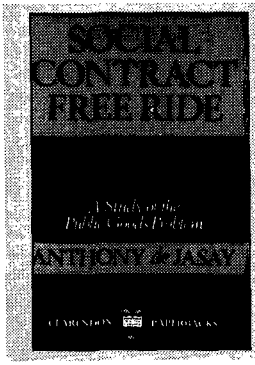

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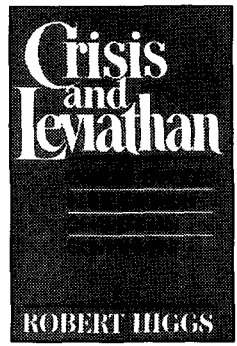

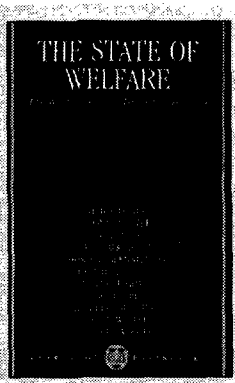

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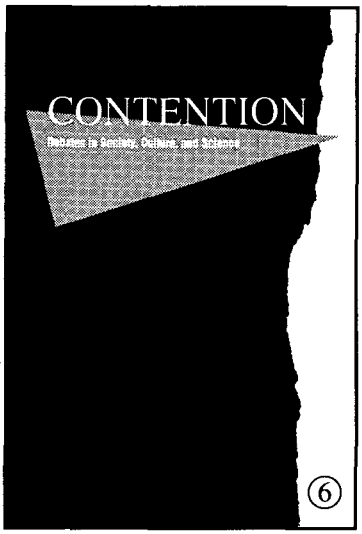

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Warren J. Samuels

THE GROWTH OF GOVERNMENT

Robert Higgs's Crisis and Leviathan *argues that there is a ratchet effect both after major wars and other serious crises, such as depressions: attitudinal or ideological changes lead not only to greater government spending but greater intrusion of government into economic command and control. Higgs's explanation of the growth of government, however, is embedded in and driven by a particular ideological view of the legal-economic world, one that misapprehends certain legal-economic fundamentals, including the scope of economic command and control, and that fails to deal with certain interpretive complexities, including alternative explanations.*

The enormous growth of government, especially government spending, in the United States in the twentieth century is an established and, for many, a much lamented fact. A second, well-established fact is the "ratchet effect": while major wars have boosted the level of government spending, that level has remained high after the onset of peace. The conventional explanation of the second phenomenon (which itself is a partial explanation of the first) is that the patriotic fervor of wartime has tended to overcome historically strong inhibitions against government spending. In *Crisis and Leviathan: Critical Episodes in the Growth of American Government* (New York: Oxford University Press, 1987), Robert Higgs

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attempts to provide a deeper and more elaborate explanation. His explanation has several parts to it: that the ratchet effect occurred not just after wars but also after several other major crises of economic adversity that produced comparable attitudinal changes; that the ratchet effect involved not just greater spending on traditional government functions but an expansion of the economic role of government into the field of economic command and control; and that the principal cause of both the ratchet effect and the expansion of the economic role of government was ideological.

Higgs is certainly warranted in finding the growth of government an interesting intellectual problem. He is sensible in focusing on the ratchet effect. He is correct in identifying ideology as a critical variable in the growth of government, including the ratchet effect. His analysis is also a good example of Joan Robinson's dictum that metaphysical-ideological propositions "express a point of view and formulate feelings which are a guide to conduct" while also providing "a quarry from which hypotheses can be drawn. They do not belong to the realm of science and yet they are necessary to it"[1]—for Higgs's positive analysis is both embedded in and driven by a particular ideological view of the legal-economic world.

In this article I shall first review the structure of Higgs's argument and then indicate what he has and has not accomplished. I shall argue that Higgs has thrown additional light on the ratchet effect but that the ideological conclusions he tries to draw from his analysis are unwarranted. Higgs does cast light on the sources of the ratchet effect and many readers of a certain predisposition will find in the book confirmation of their ideological biases, but Higgs's ideological arguments neither will nor should carry much weight with those not already inclined to agree with them. At the very least, while acknowledging Higgs's contribution to our understanding of the ratchet effect—though not necessarily its place in the explanation of the overall growth of government or, as I would prefer to put it, the history of the legal-economic nexus in the United States—I will seek to identify and make explicit the selective normative foundations of his interpretation.

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The Argument and Its Ideological Penumbra

Arthur A. Ekirch, Jr., in his Foreword, neatly encapsulates both the positive argument and its ideological penumbra. He writes that Higgs makes "an excellent case" that Big Government "has been nurtured by a succession of crises over the past century: depressions and wars that have occasioned both massive governmental spending and an increased regimentation of American life and thought. Although a crisis eventually subsides, a residue of governmental functions and authority remains; government grows bigger via a ratchet phenomenon of enlarged residual powers following each crisis" (vii). The positive argument concerns the undisputed (though possibly exaggerated and misspecified) ratchet effect; the ideology concerns the interpretation of American economic life and thought as one of "increased regimentation." The latter is affirmed by Higgs himself, when he writes that "now, in virtually every dimension, our lives revolve within rigid limits circumscribed by governmental authorities; we are constrained on all sides by . . . that awesome aggregation of forces, programs, and activities we know as Big Government" (ix).

In Chapter One Higgs criticizes several alternative hypotheses as to the sources of Big Government and the "decline of the commitment to limited government and extensive private property rights" (4). These explanations are designated as modernization, public goods, welfare state, political redistribution, ideology, and crisis. Higgs acknowledges that "many of the proposed explanations contain valid insights, and they are not necessarily mutually exclusive"; accordingly, he rejects any monocausal explanation (4). Given his problem, namely, "why the expansions of governmental power during a crisis do not disappear completely when normal socioeconomic conditions return," and "why crises led to upward-ratcheting governmental powers in the twentieth century but not in the nineteenth, which had its own emergencies," Higgs recognizes that "accounting for this difference requires that some of the other hypotheses be brought into play as complements of the Crisis Hypothesis" (18).

Higgs quite sensibly emphasizes that government is no single, homogeneous entity, not "One Big Nonhuman Thing" (6), so that different explanations may be necessary for different facets of its growth. Moreover, while government "is simply the collectivity of

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persons who exercise legal authority, . . . real government cannot survive without the sustenance and support, or at least the tolerance, of nongovernmental people"; so government is not an exogenous entity—and the source of its growth ultimately resides in ourselves.

In Chapter Two, Higgs rejects the conventional but oft-criticized view that the growth of government can be satisfactorily indicated by the growth of government spending. But whereas others emphasize that even when government spending is relatively low the economic importance of government is great, Higgs argues that there has been a growth of government command and control of the economy beyond anything suggested by the measurements of spending growth. He also contends that "the underlying essence of government . . . is coercive power" (27). The critical matter is not a government that by virtue of its spending is big, but Big Government: "What distinguishes the capital-letter leviathan is the wide scope of its effective authority over economic decision-making, that is, the great extent to which governmental officials rather than private citizens effectively decide how resources will be allocated, employed, and enjoyed" (27–28). "High levels of governmental taxing, spending, and employment derive from but are not themselves the essence of Big Government; the essence is a wide scope of effective authority over economic decision-making" (32). It is Higgs's principal message, therefore, that the "ratchet applies not only to many aspects of governmental growth as measured by standard quantitative techniques; even more importantly it applies to the essence of the emergence of Big Government, the rise of government's coercive power over economic life" (33).

Chapter Three is devoted to "ideology as an analytical concept in the study of political economy." Unfortunately Higgs does not apply this analysis to his own ideology.[2] Key points are, first, that the study of rhetoric can be a tool of research (52); second, that ideology can be treated as both exogenous to political and socio-economic change and an operative endogenous variable (54); and third, that "beliefs matter, and ideologies are the belief systems of greatest consequence for the political economy" (54).

Chapter Four takes a schematic view of the problem of ratchet. Higgs argues that citizens have been induced to tolerate Big Government because the increased costs have been concealed from them. Government has driven "a wedge between the actual and the

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publicly perceived costs" (65), in part by fiscal illusion; in part by substitution of a command for a market economy, which prevents costs from being registered in the market or as taxes, for instance, by distributing costs (such as the draft) to politically weak people; and in part by avoiding payment of the full opportunity costs of its acquisitions and actions. Therefore:

> Inability to levy taxes and then purchase on the open market everything it wishes to use in carrying out its policy shows that the government values the activity more than the citizens, that it takes from them coercively more than they are willing to supply voluntarily at a free-market price. (67)

According to Higgs, the upward ratchet of government spending and of Government (capital G) itself is "much more than the proliferation of bureaucrats and their decrees. It also involves important changes in judicial interpretations of rights and obligations under the Constitution as well as new statutory constraints placed directly on economic actors by Congress without any new regulatory agencies or additional governmental employees" (68): for example, it involves a "welfare latitudinarianism" that is "more favorable to established than proposed governmental actions" (69). All of this is primarily the result of *ideological change*: "the major crises of twentieth-century America somehow caused changes in ideology and . . . these in turn somehow facilitated a permanent enlargement of government" (70). Moreover, "the direction in which the evolutionary process carries complexes of belief and practice is not random; it is path-dependent" and "self-reinforcing" (71); there is "ideological learning . . . as a result of social crisis" (72). Ideological learning and change can be contradictory, however, and the actual result is a function of the relative weight of the opposing forces of progressive versus reactionary movements of ideology (72). So, while the ratchet is due in part to the hiddenness of its costs, it is largely a function of "a quasi-autonomous government responding to an insistent but ill-defined public demand that the government 'do something' about a crisis" (73).

The next six chapters examine, respectively, the depression of 1893–1896, the Progressive Era, World War I, the Great Depression, World War II, and, more selectively, the 40 or so years after the end of World War II. A short concluding chapter restates the principal themes of the book.

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Higgs maintains that a Schumpeterian economy driven by capitalist "creative destruction" was ideologically sustained from the Civil War through the depression of 1893–1896. The high points were the saving of the gold standard, the maintenance of law and order in the labor market, and escape from a federal income tax. During this period Higgs finds "a firm commitment to extensive, secure private property rights" and a belief that less government is better than more "*except*—and it is a critically important exception—where extraordinary action is required to maintain law and order, including the monetary order of the economy" (104). He therefore sees "no ideological contradiction whatever between the government's lack of interest in work-relief programs or agricultural price-fixing schemes and its vigorous intervention in the labor disturbances at Chicago and elsewhere" (104).

Higgs portrays the Progressive Era as a bridge from the old regime to modern times. He focuses on the income tax and the Federal Reserve System as institutional correlatives of ideological transformation. "The dominant ideology of political and economic elites had now become one that not only tolerated a greatly expanded role for government in economic decision-making; it positively insisted on such activism" (121–22). Thus began the creation of the modern mixed economy.

World War I furthered the ideological transformation. In order to sustain support for the war and keep Wilson's government in power, the war's "costs had to be at least partially concealed" (157)—which meant that arrangements were made to avoid the market for men and materials, that is, to avoid "the true social costs of shifting massive amounts of resources to new uses with extraordinary haste" (157). Moreover, prowar propaganda changed people's tastes, so that not only the financial but the ideological costs of war were kept down. (Higgs surprisingly does not invoke James Buchanan's reasoning that the effective demand for war was enhanced by lowering the tax price of the war.) The most important legacy of the war was that with resistance to governmental direction of the economy overcome in wartime, collectivism was much easier to advocate in times of peace.

The New Deal both continued and strengthened the departure from past inhibitions. While again pointing to "the institutional legacies of those fateful years" (194), Higgs insists that

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> The most important legacy of the New Deal . . . is a certain system of belief, the now-dominant ideology of the mixed economy, which holds that the government is an immensely useful means for achieving one's private aspirations and that one's resort to this reservoir of potentially appropriable benefits is perfectly legitimate. . . . The commitment of both masses and elites to individualism, free markets, and limited government suffered a blow in the 1930s from which it is unlikely ever to recover fully. In place of the old beliefs there now prevails a greater toleration of, and even a positive demand for, collectivist schemes that promise social security, protection from the rigors of market competition, and very often—to be blunt—something for nothing. (195)

World War II both repeated and expanded the experience of the first World War, "until during the final two years of the war, a thoroughgoing garrison economy had been brought into operation. Fundamentally the authorities, not the market, determined what, how, and for whom the economy would produce under this regime" (235). Not only was "military conscription, a transparent example of involuntary servitude," now seen as "morally untarnished" (235), but "the war moved the prevailing ideology markedly toward the acceptance of an enlarged government presence in the economy. At last even the majority of businessmen had come to accept, and often to demand, Big Government" (236).

The period from the end of World War II to the 1980s is comprehended by Higgs as the latest culmination of the ideological transformation that has permitted greater governmental command and control over the economy. Even "Reagan's 'conservative revolution' barely dented the enormous apparatus of governmental control" characterized by the "fundamental abrogation of private economic rights" (257).

Critique: Government Power as an Ideological Construct

Higgs is correct about two things, that the ratchet effect took place and that there has been ideological transformation. Neither of these is an original discovery, but he has presented evidence as to the sources of both on a scale not hitherto undertaken in one place, perhaps because no one believed that such was necessary. But the crux of Higgs's argument is that the ratchet effect took place not only, or not so much or so fundamentally, with regard to the level of government spending, which of course it surely did, but with

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regard to the level of government command and control—the central result of "crisis-induced reduction of resistance to Big Government" (74). It is this part of his argument that is deficient and unpersuasive. I will present my case in a schematic manner.[2] In part, my argument is that the fact of ideological transformation should not be taken as equivalent to a fundamental transformation of practice.

Let me first deal with the question of the general ideology that frames Higgs's analysis. Higgs has a conception of the ideal U.S. economy in which private property rights are absolute, the market reigns supreme, and government is limited to protecting property and the law and order of the market. The massive departures from this ideal evident in the twentieth-century U.S. political economy are characterized in terms such as "increased regimentation of American life and thought" (vii); "a uniquely American form of participatory fascism" (256); Big Government; and collectivist planning (71). Higgs even calls FDR's 1933 bank holiday "the artificial and possibly contrived crisis produced by completely closing every bank in the country, America's own 'burning of the Reichstag'" (194). All of this may satisfy libertarian and conservative emotions, but it ignores the following points:

1. Government is fundamental to the economic system; among other things, it is the process through which the basic economic institutions are determined. The distinction between "big government" and "Big Government" is, therefore, extremely misleading, to the point of fundamental conceptual error. Different specifications and assignments of rights produce different resource allocations, different income distributions, and differences in other indicia of economic performance. In the words of Ronald Coase, in the real world "the rights which individuals possess, with their duties and privileges, will be, to a large extent, what the law determines. As a result, the legal system will have a profound effect on the working of the economic system and may in certain respects be said to control it."[4] In the Coasian model, even "the distinction between firm and market is to a great extent determined by the law."[5] Higgs's treatment of private property and the market fails to acknowledge the fundamental legal bases of economic organization and performance; either private property and market are treated as given institutions or certain forms of them are given a privileged position. Government inevitably prefigures or structures economic

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activity in a nominally market and private-property economy. It does so through all the laws that determine whose interests will be protected as rights and whose will not only not be protected but left exposed to the protected interests—rights—of others. Even the "simple" protection of private-property "rights" privileges a certain way of bundling and allocating authority over economic resources and legitimates the resulting distribution of costs and benefits. Hence it is an illusion to distinguish between political economies by referring to the extent of government "intervention." Even in a libertarian utopia, government intervention, so-called, would be universal, in that the whole system would depend on government determination and enforcement of a certain form of property (and other) rights. That the agencies determining and enforcing those rights might be primarily judicial rather than legislative and bureaucratic would not make them any less governmental.

Among other things, Higgs's ideological framework leads him to seriously neglect the use made of law to transform the U.S. economy from a rural, agrarian system to an urban, business system, from a *Gemeinschaft* to a *Gesellschaft* society and, eventually, from an economy of primarily independent individual entrepreneurs to one of large corporations. Such legal historians as Lawrence M. Friedman, Morton J. Horwitz, James Willard Hurst, and Harry Scheiber, as well as John R. Commons, have documented the fundamental role played by law in transforming the economy into modern capitalism. While the forms of government command and control were different, the legal determination of economic structure and performance was no less fundamental earlier than it is now.

2. The questions are, therefore, not whether there is to be government or no government, or whether there is to be little government or much government, or whether there is to be government "intervention," but who is to control and use government and whose interests is government to promote and whose to inhibit. The question is not whether there is to be law and order but law and order on which/whose terms, or which law and order. Positions on the rejected questions typically comprise selective implicit agendas for government, even when government is explicitly denigrated.

3. Inevitably, government will protect some interests as property and fail to protect others. Interests are not protected because they

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are property; rather, "property" is one way of labeling protected interests. Both the enforcement of "property" rights primarily by courts and the enforcement of labor and consumer interests primarily by legislatures and bureaucracies are modes of government command and control. The "welfare state" is no less a form of property defense than is the "night-watchman" state that protects different interests.

What are normally considered "rights" often, perhaps typically, derive from past legislative actions or judicial decisions that protected certain interests and in effect if not by intention regulated other interests. Regulation is a mode of interest protection, as is property; indeed, property involves the regulation of others' opportunities and behavior. Deregulation is the analytical equivalent of regulation in that each protects interests, albeit opposite ones.

4. What each generation sanctifies as private property is the private-property rights of an earlier generation *as modified by law during the interim*. Property and market are neither independent nor self-subsistent; each emanates from the legal-economic nexus. The privileged position so typically given to private property is, therefore, on the one hand, temporally specific as to content, and on the other, typically devoid of reference to the power-play origins and selective use of government from which the rights originated, and were changed, over time.

5. Higgs is concerned only with the federal government (6). This is not the place to consider the transformation of federalism under the aegis of the emergence of national markets and national problems. This transformation was both partial cause and partial consequence of the concurrent ideological transformation. Certainly if one is going to comprehend the command-and-control activities of government, then one has to consider the state and local governments which formerly undertook many of the activities of today's "Big" (federal) government—and which continue to be importantly active in the economic realm, the growth of the federal government notwithstanding.

6. It would be one thing to distinguish big from small government in terms of the size of its expenditures. But the type of activity that Higgs designates as command and control is but another form of protecting interests, so Higgs's Big Government merely does, in different ways, what it has been doing all along. The forms of interest protection may change—involving greater spending,

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new governmental agencies, and even ideological change—but the function is arguably essentially the same. That "Big" government influences economic structure and performance through welfare state legislation more conspicuously than before is a function of selective perception that is influenced by ideology; but conspicuous or not, government influence is now no more fundamental than when it protected certain interests selectively by designating them as property.

The foregoing means that the protection of new interests as rights, though not as property rights, need not be understood as constituting the replacement of the market. Markets are always a function of the institutions—including sets of rights—that give rise to and operate through them. There is no conclusive reason to privilege one market, and its foundational set of rights, relative to another, with its set of rights. The decision to reform rights is not a decision to depart from the market but to rely upon a new structure of rights and the market to which it gives effect.

7. While I agree that there has been a transformation of ideology along the lines which Higgs identifies, what happened was much more complicated. First of all, even during the heyday of ideological laissez faire, individuals and groups made recourse to government to advance their interests through favorable legislation and court decisions. At no time in history have ideological restraints inhibited Americans' expectations from government. The "natural" stance of Americans has not been to go it alone, but to turn to government unhesitatingly, even though government action was erroneously considered the exception rather than the rule. To simplify matters considerably, we might say that Americans have always liked what we now call the market but have frequently disliked its structure and performance. In the eighteenth and nineteenth centuries, government action to alter "the market" typically did not involve much spending; in the twentieth century, it has. But the laissez-faire ideology never was an accurate description of practice. Indeed, as Higgs himself recognizes, ideology is an object of control and manipulation. Efforts are continually being made to obfuscate the role of government in defining and creating the economy so as to selectively channel both the definition and the re-creation; these efforts are part of the process of definition and re-creation itself.

Second, the ratchet effect cannot be explained in terms of an

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ideological transformation that occurred independently of a transformation of the power structure. A wider range of interests now has access to government as a result of an expanded franchise and other increasingly democratic arrangements. Just as the interest groups that had power in the past articulated a laissez-faire ideology (no matter how distant from reality), the new groups have their own views of the role of government. (In this context it is worth remarking that Higgs recognizes the heterogeneity of government and of ideology but not of the population; contrast the political sociology of Vilfredo Pareto.) So while there has been some transformation of ideology, there has been much less than Higgs's argument requires. Established interests in the nineteenth century considered as radical interventionism only the use of government by more pluralistic interests. The selective invocation of the market and of private property functions to defend a temporally specific, historically contingent status quo.

Third, while Higgs sensibly argues that "one can study the rhetoric of opinion leaders in times of crisis to determine what the dominant ideologies were and how they changed over time" (52), he overlooks the serious hermeneutic problems of such studies. Not the least problem is that rhetoric typically comprises code words whose meaning is not always self-evident. Consequently, the meaning of the rhetoric of a particular period cannot readily be comprehended by scholars in another period. In any event, the ascribed meaning will likely owe more to the interpreter than to the original speaker or writer. Among the historically significant examples are the uses of "freedom," "coercion," and "government" itself.

8. Higgs fails to consider alternative explanations for the ratchet effect, such as the crisis-period demonstration effect. During wars and depressions the predicaments of the disadvantaged are more readily observable than during calmer periods, when attention is directed elsewhere and when the claim that the disadvantaged are the cause of their own difficulties is more plausible.

A more general formulation of this explanation would be that a crisis provides evidence, hitherto less evident or repressed, of the gap between ideology and reality (which may well be a gap between two different ideological definitions of reality), thereby leading to demands for legal change and other reforms.

A second but not mutually exclusive alternative explanation of

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the ratchet effect is in the context of the cyclical movements of policy—now conservative/reactionary, now liberal/radical—which historians such as Merle Curti and Arthur Schlesinger, Jr. have identified.

A third alternative would emphasize that the newly protected interests are those of corporations rather than the lower socioeconomic classes. The ascendence of the corporate system on the one hand and of the welfare state on the other—each with its evident demands for the protection of interests—is in some respects a matter of ideological transformation, and in others a matter of change in power structure; but it can also be understood as a matter of systemic transformation. By no means are all of these considerations encapsulated by Higgs's treatment of "modernization," the welfare state, and political redistribution as explanations of the growth of government (Chapter One).

A fourth explanation is that the use of government during crisis periods generates a social learning process in which greater experience with legislative and bureaucratic government leads to a greater willingness to rely on such government. While in a sense Higgs's account recognizes the existence of this learning curve (260 and passim), his (ideologically driven) determination to interpret it as the growth of a collectivist ideology masks a more neutral reading of it.

9. Higgs's terminology of "critical episodes" can be misleading. Neither world wars (or wars of any dimension) nor depressions are aberrational, episodic phenomena. Wars are derivative of, among other things, the nation-state system and have both narrowly political and economic origins; and business cycles generally are a distinct aspect of the dynamics of capitalist systems, or of economic systems generally. While it is true that one source of the persistence of government programs generated during times of crisis is that bureaucrats and beneficiaries of those programs have an interest in their continuation, another reason is that the problems highlighted during the crisis continue after the crisis passes. Crises that ratchet up the administrative state therefore are not aberrations; they have deeper significance. Indeed, the transformation of entrepreneurial capitalism into corporate capitalism and the putative increase in the political significance of the masses may have been the result of systemic pressures that were "waiting for" a crisis to give them institutional form.

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10. Higgs argues that crises in the nineteenth century did not have the transforming effect that they came to have in the twentieth century. If that is the case, it is arguable that this was because the Civil War and the depression decades of 1872–1879, 1883–1885, and 1893–1896 antedated the initial pluralization of the U.S. political economy. Still, many twentieth-century radical and other reform movements date from the great depression of the 1870s; more generally, those crises arguably set the stage for reform demands that came later.

11. Higgs's ideological position, one widely held, posits that "the underlying essence of government . . . is coercive power" (27; see also 57). That is not wrong but it is not entirely adequate. Government itself is both a dependent and an independent variable: Government coerces individuals and groups but individuals and groups "coerce" government, in the same sense, so as to coerce others. Government both coerces and acts to counteract coercion. It is easy to believe that government power employed in favor of one's interests is not coercion, whereas that power employed in support of others' interests is coercion. But this is an illusion based on selective perception.

12. Higgs makes of the market the privileged forum for reaching collective decisions. But there are two fundamental problems with this. First, there is no such thing as "the" market. Real-world markets are formed by institutions, especially the legal institutions which then operate through them. These markets are subject to continuous social reconstruction, with different legal foundations producing different markets and different arrays of economic performance. Second, economic exchange has never been the only accepted or actual decisionmaking process in American society. Moral rules, custom, religion, law, and yes, ideology together make up the American system of social control. Higgs manifestly dislikes both political power and social control (257 and passim), but social control (i.e., social decisionmaking) is to be found in all societies, and political power is in modern societies a very important mode of it. When one further recognizes that particular markets are a function of particular power structures, and that the corporate system has to a large extent replaced the system of individual entrepreneurs, affirmation of "the" market constitutes affirmation of the power of corporations and the corporate system.

13. What constitutes "activist government," "freedom," or "coer-

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cion" is a matter of selective perception. One's perceptions are selected by one's ideology. By accepting an ideology that equates freedom with status quo property relations, Higgs unwittingly aligns himself with status quo property interests. By the same token he equates change or reform with coercion. This is not to say that Higgs defends the status quo of late-twentieth-century America; rather, he clings to the idealized status quo that has been displaced by a new power structure, which he tendentiously calls Big Government.

There is something like a constant level of coercive command and control in society, some of it in "private," some in "public" hands. Just what is "public" and what is "private" is, like the questions of whose interests are to be enshrined as "rights," a matter of selective perception. Higgs, like most libertarians, takes his ideological perceptions for granted.

* * *

We have governmental activism whether we like it or not. We have to choose what we want government to do, which is what the political process is all about. For all of Higgs's more or less limited contribution to understanding the ratchet effect, his is principally an exercise in ideological manipulation. One can sympathize with his concluding pessimism that things will not, by his lights, improve (262), but that sympathy is tempered by a sense that such "improvement" would constitute the reestablishment of an economic oligarchy. Someone influenced by Pareto might say in response that it is a choice between one elite and another and I would be hard pressed to disagree, though I would prefer to think of modern liberal democracies as processes of collective bargaining amongst many interests, and not the hegemony of one or a few. Still, scholarship requires that the concepts of private property, individualism, limited government, and the market be treated more carefully than the ideology resonant throughout this book seems to permit.

NOTES

1. Joan Robinson, *Economic Philosophy* (Chicago: Aldine, 1962), 3.
2. Higgs does, to his credit, insist that "the most fundamental danger must be faced: the analyst may become an ideologue. In social thought a thin line

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separates ideology from science, 'since the latter is very often ideological in both its roots and consequences'" (55, quoting Martin Seliger). But he does not apply this thought to his own work.

3. The analytical bases of the themes presented below are found in Warren J. Samuels, *Essays on the Economic Role of Government*, 2 vols. (New York: New York University Press, 1992).
4. Ronald H. Coase, "The Institutional Structure of Production," *American Economic Review* 82 (September 1992): 717–18.
5. R. Rothschild, Book Review, *Economic Journal* 102 (September 1992): 1293.

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Theodore R. Marmor

UNDERSTANDING THE WELFARE STATE: CRISIS, CRITICS, AND COUNTERCRITICS

We are now seeing a new wave of literature about the "crisis" of the welfare state. In the earlier wave, some critics charged that social spending significantly detracted from macro- or microeconomic performance, while others challenged the legitimacy or efficacy of welfare programs; a third group worried about the effect of macroeconomic problems on the viability of the welfare state. None of these criticisms can be said to have been satisfactory, and continued reiterations of them betray a lack of cross-national perspective and a priori reasoning about empirical matters. Works with greater historical depth and more recent studies constitute a much-needed reaction against the "crisis" literature.

In the foreword to his 1991 work on *Social Change, Social Welfare, and Social Science*, Peter Taylor-Gooby begins by citing a preacher's lament that "of making many books there is no end, and much study is a weariness of the flesh." As he notes, this is clearly the case in the "social welfare business," where "books on the welfare state are now coming out faster than the scholar can decently read them."[1] How right he is, which is the painful dilemma facing any-

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one writing a review essay on recent studies of the modern welfare state.

With few exceptions, however, welfare-state scholarship of the past two decades tells very familiar stories, tales dominated by whether the author is a critic, a defender, or simply a confused observer of the mélange of programs we conveniently (but also misleadingly) collect together under the "welfare state" rubric. The surge of books began in the 1970s, when economic conditions strained public budgets everywhere. This first wave was dominated by critics, those who attacked the desirability, affordability, and governability of social-welfare programs in the OECD world, mostly from the pro-market right, but also from the left side of the political spectrum. As I will try to show, these claims reveal a persistent pattern of empirical sloppiness, ideological conviction, and widespread diffusion. What is new about the new wave of works is their attack on the welfare state's critics, a shoring up of the intellectual defenses of the welfare state by sometimes weary, sometimes passionate countercritics.

The Crisis of the Welfare State

The last two decades have quite obviously been painful economically. The persistent stagflation of the Seventies reversed the favorable terms of the postwar expansion of welfare states. Instead of growing economies and dampened inflation, we have learned to live with slowing economies and heightened inflation. And although during the Eighties we largely tamed inflation, citizens have almost come to expect comparatively high rates of unemployment, modest rates of economic growth, large government deficits, and straitened circumstances for many of the poor who depend on government programs. It has been a bracing period for welfare states, one that has occasioned wide-ranging intellectual arguments as to their contemporary circumstances, historical causes and likely future.

The claim of crisis has become a major if not dominant motif of this debate. First widely voiced in the early Seventies, the allegation of crisis became a staple of political discussion in the Eighties. It is associated with calls for a radical restructuring of social-welfare programs which throughout the industrial democracies ex-

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panded greatly in the postwar period. In the American political context, this critical interpretation was identified with the election of Ronald Reagan in 1980 and his administration's subsequent attacks on federal social spending. In Europe, it is associated with the triumph and continued victories of Margaret Thatcher and with shifts away from social-democratic control in Sweden and Australia in the Seventies, followed by France, Germany, and Canada. In both Europe and North America, some left-wing critics came to see social welfare strains as evidence of both the "fiscal crisis of the state" and the limits of bureaucratic paternalism.[2]

These fevered discussions, relying on unclear and often misunderstood terms and data, show great confusion as to exactly what is meant by "the crisis of the welfare state." Are the social *policies* of the modern state in crisis? Or is the state itself in crisis because desirable welfare commitments overwhelm its diminished fiscal capacity? Are we referring to the major spending programs of contemporary governments—pensions, medical care, education and housing? The biggest medical care and pension programs are cross-nationally popular. Is the crisis, then, to do with finding the means to finance crucial—and popular—commitments? Or is the problem the extension of government authority into such disputed policy areas as abortion and busing in the United States, the treatment of French-speakers in Canada, guest-workers in Germany and Sweden, and so on? Or, more discouragingly, is the crisis of the welfare state one of programmatic failure, humane intentions gone wrong in execution?

The impulse to sort out the disagreements is understandable. Some of the topic's contentiousness can be avoided if one changes the question asked, shifting from an evaluative to an historical perspective. Peter Flora and Arnold Heidenheimer's *The Development of Welfare States in Europe and America*, for example, draws attention away from the welfare-state circumstances of the Seventies to the origins and evolution of those conditions over the course of the twentieth century.[3] Douglas Ashford, as we shall see, pushes the historical focus further back and asks what the growth of welfare states reveals about the institutional capacities of particular states, especially Britain and France. In both instances, the historical development of welfare states, rather than the character, causes and implications of contemporary disputes, is the main subject. It may well be that the historical understanding thus arrived at will

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illuminate contemporary disputes, but there can be no assurance of this.

Another approach is to assume that we know what the "crisis" is and proceed to ask about its causes and prospects. This was the approach taken by the OECD in the late Seventies and early Eighties. Two years of work went into preparing for a 1980 conference in Paris on social policies in the Eighties. But the book that emerged from the conference—*The Welfare State in Crisis*[4]—showed little consensus that a crisis in fact existed. Although the book was based on the assumption that its contributors all had a similar understanding of the worrying condition whose prospects for improvement they were addressing, this was not actually the case. Some contributors asked why protests had emerged in such a wide variety of welfare states. Some emphasized the tradeoffs between investment and consumption policies in the modern state. Others concentrated on the values of citizens in modern states with extensive social programs. Neither the developmental approach nor the one which (prematurely) assumes agreement on the problem promises an adequate understanding of the contemporary problems of the welfare state, however. To understand the "crisis" debate, other starting points are needed.

The literature on the welfare state falls into at least three broad categories. Some analysts regard the welfare state's growth as the main cause of its contemporary political troubles. Most often associated with the apocalyptic Right, those who espouse this belief focus on ways of restraining the over-reaching state and redeveloping the institutions of the market and the hegemony of individual choice. Others see the modern state's experience with slowed economic growth as the source of the political controversies. These incrementalists of the center are preoccupied with the ways in which fiscal strain and stagflation have required cutbacks. They attribute the current crisis to fiscal demands *on* welfare-state programs rather than to inherent defects *of* welfare-state institutions. They assume that if and when economic growth resumes, the welfare state's so-called crisis will abate. A third group stresses the controversies over particular social programs (not fiscally important ones, quite often) that raise issues of legitimate governmental purpose. Proponents of this view see the strains on the welfare state as evidence of the contradictions of modern capitalism, and the crisis in the modern welfare state as a portent of future troubles. An

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important variant of this argument emphasizes the failure of welfare-state programs to achieve their objectives, not simply the controversiality of the attempts to do so. There are, of course, overlaps among these three approaches and the first two can, without heroic effort, be tightly linked. But there are differences, and they affect how one maps the subject.

Critics of "Big Government"

The first approach assumes that social-welfare programs played a major role in the poor economic performance of the Seventies. At its simplest, the argument here is that social programs compete with other budget outlays, preventing a proper macroeconomic balance between investment and consumption. Some critics, such as Richard Rose and Guy Peters,[5] insist that this imbalance is "bankrupting" the state. Others, like Richard Wagner in *To Promote the General Welfare* (San Francisco: Pacific Research Institute, 1989) simply assert that the welfare state has reduced overall economic performance. The second form of this argument stresses that many social programs indirectly impede the mobility of capital and labor. It is important, however, to note that the two versions of this argument offer very different interpretations of the undeniable growth of welfare spending during the Sixties and early Seventies. In the first case, the argument treats spending as the problem. In the second, the rigidities are not centrally involved with the largest spending programs, though unemployment insurance is certainly important in budgetary terms.

Fiscally, the most substantial expansion of public social welfare took place in the Sixties and early Seventies (see Table 1). Criticisms of the growing size of the welfare state became more widespread after the strains of stagflation spread in the wake of the 1973–74 oil shock. Yet the striking feature of these criticisms is their familiarity. They represent the oldest objections to the very enactment of social-welfare programs in the first place.

It is worth noting that the worst scenario—the bankruptcy view—was discredited almost as it was generated. The major spending programs did not continue to grow as if out of control. Expansion did not continue automatically in the midst of fiscal strain; everywhere, review and restraint took place, though often—

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Table 1: Social Expenditures in Selected OECD Countries: Average Annual Growth Rate of Deflated Social Expenditures* (%)

	1960–1975	1975–1981
Canada	9.3	3.1
France	7.3†	6.2
Germany	7.0	2.4
Italy	7.7	5.1
Japan	12.8	8.4
Norway	10.1	4.6
United Kingdom	5.9	1.8
United States	8.0	3.2

* Defined as education, health care, pensions and unemployment compensation; deflated expenditure is public expenditure measured at constant GDP prices.

† Excluding education.

Source: *Social Expenditure: 1960–1990, Problems of Growth and Control* (OECD, 1985). Table One, p. 21.

as Jens Albers has made clear—without leading to a clarification of purposes or a rationalization of structures. It is also worth noting that big social welfare spenders did not necessarily have the most serious growth problems in the Seventies. The simple connection between the size of the public (or social-welfare) sector and problems of economic growth does not hold up under comparative scrutiny.[6]

Critics of "Fiscal Crisis"

The second approach interprets the worldwide recession of the mid-Seventies as critically threatening *to* the welfare state. The combination of lower rates of economic growth, increasing levels of unemployment, and worrying levels of investment placed under stress the programs that had experienced rapid growth in the earlier decade. In the short run, welfare-state programs cushioned the effects of the recession. But because inflation and unemployment increased government outlays while the recession reduced government revenues, the fiscal strain quickly became apparent.[7] In the longer term, the prospect of pressure on medical care and pensions is (and proved to be) unavoidable. But specters of the future are sometimes used to prod immediate action through panic-

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mongering. It is important to keep in mind the difference between the short-term effects of stagflation and the structural-demographic prospects for major spending programs over time.

The relation between welfare-state growth and present fiscal strain has another dimension. During the Sixties, when program expansion took place under exceedingly favorable economic circumstances, policymakers gave little thought to what would happen under adverse economic conditions. In most countries the central ideas of the welfare state were canonized rather than analyzed. There was little consideration of alternative means to settled ends. Conversely, in the United States, where there was less consensus than anywhere else about the original purposes of a welfare state, the rapid growth in social programs and the nation's uncertain philosophical commitment coincided. It is therefore not surprising that welfare-state laggards like the United States and Canada have suffered the most diffuse fearfulness about the future.[8] The rate of social spending growth in the Seventies could not, in any case, have been sustained forever. But since welfare-state planning rested on either optimistic assumptions or uncertain commitments, the reversal in economic fortunes was all the more startling.

Critics of "Illegitimacy" and "Failure"

Neither of the two ways of thinking I have just outlined needs to be seen as attacking the fundamental purposes of major social welfare programs. The elimination of want, ignorance, squalor, disease and idleness are aims compatible both with the view that remedial programs have grown too costly for economic health and that, with fewer available resources, more efficient means to achieve established goals are required. However, there is a third way of looking at the social-policy "crisis" of the Seventies and Eighties that is, in some sense, more fundamental. It is the view that welfare-state programs include some efforts that are wrong, and on which public means should not be employed, even if funds were available or the effects on economic vitality were not troubling. This is what I mean by criticisms of welfare-state legitimacy.

The specific items of principled objection vary somewhat from one OECD nation to another. In the United States, AFDC (state aid to poor families), abortion, bilingualism, affirmative action, and

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school busing have been the subjects of the most vitriolic debate.[9] The British counterparts to these controversial programs are the dole and issues of immigration. In general, the claim is that family, custom, and local community, rather than governments, should regulate the definition and response to most social needs. Typically, the programs being criticized are not major sources of spending. AFDC, for example, has made a rather modest financial contribution to the overall growth of American social-welfare expenditures (see Table 2). AFDC's prominence in our debate arises from racial and moral concerns far more than fiscal ones.[10]

Despite frustrating efforts to reform AFDC over the past 20 years, sweeping legislative change has not been achieved: instead, a series of legal and political challenges has, in practice, changed some of the ways in which assistance is given, by whom and to whom. (In 1993, we find ourselves in yet another round of welfare reform debate in the OECD world.) What we see here is not so much a retreat from previous approaches to meeting welfare-state aims as a challenge to the legitimacy of the aims themselves. Analogous challenges to legitimacy have arisen in other countries, but they do not involve the same mix of programs. In Sweden and West Germany, both the treatment of "guest workers" and the structure of public education have given rise to fundamental questions.[11] In Canada, preferential policies toward French Canadians have prompted widespread objections to government involvement

Table 2: Total Federal Expenditures for Selected Social Programs (in billions of constant 1985 dollars)

	1970	1975	1980	1985
Social Security (OASDI)	78.3	123.4	153.6	186.4
Medicare	17.9	27.4	44.6	69.6
Unemployment Insurance	8.1	24.8	22.1	16.1
AFDC (Assistance Payments Program)†	10.9*	9.9	9.1	8.6
SSI	—	8.4	7.5	8.7

* Includes aid to needy aged, blind, and disabled adults, which became SSI in 1974.

† Since 1974, most outlays in the "assistance payments" category have been for Aid to Families with Dependent Children (AFDC).

Source: Congressional Research Service, *1986 Budget Perspective: Federal Spending for the Human Resource Programs,* February 1986, pp. 55 and 81.

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in the redistribution of opportunities to different language groups. My claim is simply that these disputes, coinciding with the fiscal strains in all OECD welfare states, further contributed to the sense of crisis. The addition of legitimacy concerns to fiscal fears has made more familiar methods of problem solving seem less appropriate to the state's contemporary troubles.

There is a variant of the legitimacy attack noted above that is distinguishable and important: namely, that welfare-state ends should not be pursued because the government is incompetent to accomplish them. According to this view, either the government cannot administer such programs properly or, even when administered adequately, the consequences are almost necessarily disappointing. Minimum wage laws are but one familiar example; analysts like Wagner take for granted that such programs reduce available jobs and defeat their announced income-enhancing aim. Charles Murray's *Losing Ground* takes up the familiar charge that the very presence of payments to broken families encourages both family breakup (or non-formation) and teenage pregnancy.[12] What is striking about such work is the combination of broad claim and narrow evidence. Such critics typically commit the fallacy of confusing incentives with actual behavior, one of four examples of "how not to think about the welfare state."[13] Quite obviously, the argument that public programs do not work cannot plausibly be made in general without evidence from a representative sample of the universe of programs considered. It can, however, be advanced (and is) if one simply assumes that government failure is the norm, not the exception.

The different points of view I have just described all suggest that, one way or another, the critical flaws of welfare-state programs, and thus of the welfare state itself, are part of a general dissatisfaction with modern institutions of government. This assumption rests on several factual mistakes. Cross-national polling data from the Seventies, in the period when government revenue was restrained by stagflation and the burdens on the welfare state increased, show that the major social spending programs remained broadly popular. In the United States these programs—pensions, medical care and education—never lacked public or political support. Both polls and the public reaction to attempted cutbacks by the Reagan administration testify to the popularity of these pro-

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grams.[14] The most strident criticism of the American welfare state has largely concentrated on its more fiscally trivial programs.

It is clear that the future of the welfare state in countries with large, settled programs cannot possibly replicate the extraordinary growth that marked the postwar experience. It is equally clear that the reduced growth of social spending in the Seventies and Eighties was due not simply to slower economic growth but also to the overwhelming fact that large, mature programs simply cannot continue to expand rapidly without imposing steadily increasing opportunity costs.[15] Sharp increases in already large government programs would have imposed tax burdens on those already at the bottom of the income distribution. The argument for selectivity in the growth of programs and spending therefore derives not simply from an ideological rejection of their purposes, but from the reality that these established pension, health care, and education programs reduce the margins for continued growth in the future.

OECD data on trends in social expenditure from 1960–1981 reveal both overall patterns and country-by-country and program-by-program variations.[16] First, from 1975–1981, all OECD countries reduced the rate of increase in social spending, but none reduced total social expenditures in real terms. They all held down spending increases in response to the adverse economic environment. Second, the reactions of different countries varied both in the extent to which they reduced spending growth and in the priorities accorded different spending programs.

Over the OECD as a whole, the average annual growth rate of real social spending fell, between the periods 1960–1975 and 1975–1981, from 8.4 percent to 4.8 percent. (Economic growth during the same periods fell from 4.6 to 2.6 percent.) National reductions, however, varied by a factor of eight—from 1.1 percent in France to 8.8 percent in the Netherlands. The cross-sectional data show that the higher a country's level of social spending in 1975, the lower the rate of increase from 1975 to 1981. Conversely, the countries with the highest economic growth rates from 1975 to 1981 experienced the highest rate of growth in social spending.[17]

The deviations from this general pattern which some countries exhibit are also of interest. Table 3 uses the measure of income elasticity in social spending to illustrate national differences in the relationship between change in the rate of growth in social spending and degree of general economic strain.[18] Three countries—

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Table 3: Income Elasticity* of Social Expenditures in Selected OECD Countries

	1960–1975	1975–1981†
Canada	1.8	0.9
France	2.2	2.2
Germany	0.8	0.8
Italy	1.4	1.6
Japan	3.9	1.8
Norway	2.4	1.1
United Kingdom	2.2	1.8
United States	2.4	1.0

* The ratio of the growth rate of nominal social expenditures to the growth rate of nominal GDP.

† Or latest year available.

Source: Social Expenditure: 1960–1990. Problems of Growth and Control, Table Two, p. 22.

Norway, Canada, and the United States—show substantial decline in their elasticity between the two periods. In other words, these countries experienced significantly less growth in social spending compared with their overall economic growth during the years 1975–1981 than they did during the period 1960–1975. The United States and Norway are particularly interesting in this respect because, despite their very different political traditions, they are two of the strongest "overreactors." In each case, decline in economic growth was less than the OECD average (0.2 percent for both countries as against the OECD average of 2.0 percent), and the decline in social spending growth was greater (4.6 and 5.5 points respectively, against an average of 3.6 percent). These data suggest that national perceptions and definitions of fiscal crisis are as important as economic performance in understanding welfare-state policymaking. They also make it clear that one should be skeptical of the proposition that there is "some systematic affliction common to all the advanced capitalist countries, independent of national political ideology or institutions."[19]

The Rise of the Countercritics

There is, then, precious little evidence to bolster all the talk of "crisis" in the welfare state. The institutions of the welfare state

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have not demonstrated—either in the adjustments they have made to their welfare programs or by virtue of an inability to adjust—the sense of critical disjuncture which hostile intellectuals have managed, with the help of politicians, to foster. An intellectual counter-revolution is now under way, directed against the popularizers of "crisis," aimed at discrediting their factual contentions and at showing how misleading it is to measure the performance of the welfare state against idealized conceptions of the market alternative. Two different versions of this intellectual reaction are now visible: the purpose of one is to substitute a more realistic set of concerns about the future for discredited crisis-mongering, while the other is concerned to arrive at an historical understanding of how the misleading notion of welfare-state malaise arose in different societies.

The realistic futurologists dismiss the crisis-mongers with one hand and urge prudent flexibility with the other.[20] They call our attention to the inevitable increase in the demands that will accrue upon the welfare state as the population of the elderly and frail continues to grow. They insist, rightly, that the engine of economic growth will not, in all likelihood, remove this fiscal strain and, consequently, that the call for more effective and efficient use of public funds will continue. And they urge us to consider forms of targeting—technically possible but not socially stigmatizing—to address the circumstances of the worst off without jettisoning our commitment to social security in the broad sense.

The growth of interest in the history of welfare states is a very different matter. While sharing the widespread concern about the part played by the welfare state in recent economic troubles, historians have not contributed to policy debates. Their argument is that no sense can be made of the present without an adequate account of when and how the institutions of the welfare state came into being. So it is with Douglas Ashford's magisterial *The Emergence of the Welfare States* (Oxford: Blackwell, 1986). Ashford reports his dissatisfaction with the literature we have reviewed. His response is to change the questions about the welfare state. Instead of asking so single-mindedly what their performance has been and why, he contends that we should broaden our inquiry by looking into how it is that these major institutions of all modern societies came into being and why they developed as they did. Were we to do that, he insists, our understanding of the welfare state would differ greatly from the conventional wisdom. We would see behind the superfi-

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cial similarity of programs—for the old, the sick, the disabled, the unemployed, and so on—a rich tapestry of individual polities wrestling with the competing claims of individualistic, liberal political theory and both right- and left-wing notions of community, solidarity and family protection.

Ashford proceeds to these conclusions through a set of complicated historical steps, reaching back into the nineteenth century and taking us through the Industrial Revolution. At the turn of the twentieth century, he shows there were already far-reaching debates about the role of the state in preventing or ameliorating the devastations of industrial capitalism. The story he tells is fascinating, complicated, indeed ambiguous, dealing both with the history of ideas and with the translation of ideas into political practice. But it is not a story of how welfare states have performed. Rather, Ashford has attempted to describe and explain the nature of the controversies over welfare-state expansion. He sets himself the task of explicating what became controversial and why. Further, he places those controversies in the context of competing notions of what the role of the state and of the individual should be in dealing with the risks and ravages of industrial capitalism.

The result is a quite different interpretation of the history of the British and the French welfare states. For Ashford, Britain, so long considered by Americans as the paradigm of the fully elaborated welfare state, is anomalous: a state with broad social programs whose development did little to change its polity. The British welfare state in the twentieth century has done lots of new things, but not in new ways. Instead of changing the institutions of British politics, Britain has assimilated new programs by means of the transmission belt running from Oxbridge to the elite positions in British politics and administration. France, by contrast, linked new welfare programs with the transformation of the French state. As a result, the introduction of social insurance required deeper changes in French politics. Philosophically more elaborated, the development of the French welfare state has seen a more profound transformation of the role of the citizen, incorporating unions, management and government in the administration of programs whose impact is fundamental.

Ashford's approach cannot inform the debate about how the welfare state should respond to the difficulties that now lie in wait for it. What he does is to remind us that in debating the policy

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options of the future, the behavior of governments will be sharply constrained by the capacities of their political institutions. Instead of a social-welfare machine producing policies driven by socio-economic forces in the environment, he offers us the more realistic world of national polities selecting among the available options in an environment in which institutional capacity and national understanding are crucial for what takes place. In that sense, Ashford's book is an elaborate historical confirmation of the fact that, in the words of Rudolf Klein and Michael O'Higgins, the welfare state does not change "independently of national political ideology or institutions."

My own commentary on the so-called crisis of the welfare state was itself largely written in the mid-1980s.[21] Yet it is a reasonable synopsis of the critical arguments of a number of new studies published since 1989. A partial list of these books would include John Hills, ed., *The State of Welfare: The Welfare State in Britain Since 1974*; Charles Lockhart, *Gaining Ground: Tailoring Social Programs to American Values*; Christopher Jencks, *Rethinking Social Policy: Race, Poverty and the Underclass*; Taylor-Gooby's *Social Change, Social Welfare, and Social Science*; Gosta Esping-Andersen, *The Three Worlds of Welfare Capitalism*; Christopher Pierson, *Beyond the Welfare State? The New Political Economy of Welfare*; Mickey Kaus, *The End of Equality*; and Fay Cook and Edith Barrett, *Support for the American Welfare State: The Views of Congress and the Public*.[22] This list in itself is testimony to the intellectual convergence among sympathetic analysts of the welfare state. After a decade or more of bludgeoning—of incantations about the miseries of social welfare programs—the publishing counterrevolution has fully emerged. While the attacks on the welfare state typically found their outlets in commercial publishing houses and national newspapers, the scholarly counterattack—both in Britain and the United States—has largely employed the institution of the university press. The result, of course, has been a somewhat larger gap between conception and publication.

These newer books differ, of course, in their geopolitical focus, particular emphases, and, above all, in their posture toward the future. Hill's *The State of Welfare* (Oxford: Clarendon Press, 1990) is unabashedly national in focus, emphasizing the myths, mistakes, and misapprehensions about British social-welfare programs in the 1970s and 1980s. (Indeed, the clue lies in the British use of "welfare"

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to refer to social programs generally, not, as in American English, to programs for poor people.) Similarly, the American literature is by and large ethnocentric in programmatic focus. *Gaining Ground* seeks to link social programs more enduringly and accurately to American values. Jencks's form of *Rethinking Social Policy* expresses "prejudices" he candidly describes as "cultural conservatism, economic egalitarianism, and incremental reform." Impressed by "the way Swedish socialists transformed their society after World War II" in discrete steps, Jencks draws a lesson from abroad, but does not comment further on the international intellectual struggle over the welfare state.

Disciplinary and geographical provincialism reaches its nadir, however, in Wagner's previously mentioned *To Promote the General Welfare*. The arguments for the welfare state, according to Wagner, have everything to do with ideas of market failure and practically nothing to do with social insurance and social-democratic ideas of risk pooling and, especially, social equality. This ahistorical claim is mirrored by a bibliography that concentrates on the works of economists (and a few philosophers) but never mentions the writings of such American commentators as Christopher Jencks, Francis Fox Piven, Robert Ball, Jerry Mashaw, Ed Berkowitz, Theda Skocpol, or Barbara Ehrenreich, let alone the influential earlier work of the English welfare-state enthusiasts like R.H. Tawney and Richard Titmuss or Northern European commentators like Esping-Anderson and Walter Korpi.[23] The restricted range of public-choice literature like Wagner's is truly stunning.

By contrast, the work of Douglas Ashford, Peter Flora, Arnold Heidenheimer, Jens Alber, and the OECD was cross-national. They were responding to the international salience of arguments in the 1970s that the welfare state was unsustainable in its growth mode. Precisely because of that, their focus was on claims and evidence that cross-national study could illuminate. The newer books are more inclined to ask what lessons for the future of their nations' social policy can be drawn from the broad challenges to the welfare state and the answers to them. Not surprisingly, intellectual work proceeds in fits and starts. And, surely, this wave of work will generate its own antithesis, some of it no doubt in these very pages.

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NOTES

Permission to reprint some material in this essay from the author's "Crisis-Mongering," *London Review of Books*, May 21, 1987, is gratefully acknowledged.

1. Peter Taylor-Gooby, *Social Change, Social Welfare, and Social Science* (Toronto: University of Toronto Press, 1991), xi.
2. Conference on Social Policies in the 1980s, *The Welfare State in Crisis* (Paris: OECD, 1981), 5.
3. Peter Flora and Arnold Heidenheimer, *The Development of Welfare States in Europe and America* (New Brunswick, N.J.: Transaction Books, 1981).
4. *The Welfare State in Crisis*.
5. Richard Rose and Guy Peters, *Can Governments Go Bankrupt?* (New York: Basic Books, 1978).
6. For further discussion see David Cameron, "On the Limits of the Public Economy," *Annals of the American Academy of Political and Social Science* no. 459 (1982), and Manfred Schmidt, "The Welfare State and the Economy in Periods of Economic Crisis," *European Journal of Political Research* no. 11 (1983): 1–26.
7. Daniel Tarshys, "Curbing Public Expenditure: Current Trends," *Journal of Public Policy* no. 7 (1985): 23–67.
8. See Robert Kudrle and Theodore Marmor, "The Development of Welfare States in North America," in Flora and Heidenheimer, esp. 114–116.
9. The celebrated public disputes over Charles Murray's *Losing Ground* are a good example. Few such exchanges have addressed Social Security pensions or Medicare, programs that are far more significant fiscally (as Table 2 shows) than the whole nest of poverty and public programs.
10. It is true that some critics of public welfare, such as Murray, also emphasize the consequences for work incentives of public assistance rules and regulations.
11. See Flora and Heidenheimer.
12. Charles Murray, *Losing Ground: American Social Policy 1950–1980* (New York: Basic Books, 1984).
13. See Theodore R. Marmor, Jerry L. Mashaw and Philip L. Harvey, *America's Misunderstood Welfare State: Persistent Myths, Continuing Realities* (New York: Basic Books, 1992), ch. 7.
14. Richard Neustadt and Ernest May, *Thinking in Time: The Uses of History for Decision-Makers* (New York: Free Press, 1986); Paul Light, *Artful Work: The Politics of Social Security Reform* (New York: Random House, 1985).
15. Rudolf Klein and Michael O'Higgins, "Defusing the Crisis of the Welfare State: A New Interpretation," in Theodore R. Marmor and Jerry L. Mashaw, eds., *Social Security in Contemporary American Politics* (forthcoming).
16. *Social Expenditure: 1960–1981, Problems of Growth and Control* (Paris: OECD, 1985). I am indebted to Rudolf Klein and Michael O'Higgins of the University of Bath for their analysis of these data. While the report makes

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comparable data conveniently available, it has the disadvantage of ending its time series in 1981. Further, by treating the periods 1960–1975 and 1975–1981 as though each were homogeneous, the study may suggest conclusions that would not hold if the focus of analysis were on trends *within* each of these periods. In addition, the form in which these data are presented begs the question of whether, in the words of the OECD report, "the passage of time would probably have seen some automatic moderation as the major social programs approached maturity" (9).

17. Details of their analysis can be found in Klein and O'Higgins, n15 above.
18. The income elasticity of social expenditures is defined as the ratio of the growth rate of nominal social expenditures to the growth rate of nominal GDP. An income elasticity of less than 1.0 indicates that a given percentage increase in economic growth was matched by the same percentage increase in social expenditures.
19. Klein and O'Higgins, n15 above.
20. See, for example, A. J. Culyer, "The Withering of the Welfare State? Whither the Welfare State?" (typescript, Department of Social Policy, University of British Columbia, 1986); Rudolf Klein and Michael O'Higgins, eds., *The Future of Welfare* (Oxford: Blackwell, 1985); and Klein and O'Higgins, n15 above.
21. See *America's Misunderstood Welfare State*, n13 above.
22. Charles Lockhart, *Gaining Ground: Tailoring Social Programs to American Values* (Berkeley: University of California Press, 1989); Christopher Jencks, *Rethinking Social Policy: Race, Poverty and the Underclass* (Cambridge, Mass.: Harvard University Press, 1992); Gosta Esping-Andersen, *The Three Worlds of Welfare Capitalism* (Princeton: Princeton University Press, 1990); Christopher Pierson, *Beyond the Welfare State? The New Political Economy of Welfare* (University Park: Pennsylvania State University Press, 1988); Mickey Kaus, *The End of Equality* (New York: Basic Books, 1992); Fay Cook and Edith Barrett, *Support for the American Welfare State: The Views of Congress and the Public* (New York: Columbia University Press, 1992).
23. See Francis Fox Piven, *Regulating the Poor* (New York: Pantheon, 1971); Robert Ball, *Social Security, Today and Tomorrow* (New York: Columbia University Press, 1978); Jerry Mashaw and Theodore Marmor, *Social Security: Beyond the Rhetoric of Crisis* (Princeton: Princeton University Press, 1988); Edward Berkowitz, *America's Welfare State From Roosevelt to Reagan* (Baltimore: Johns Hopkins University Press, 1991); Theda Skocpol, Margaret Weir and Ann Shola Orloff, eds., *Politics of Social Policy in the United States* (Princeton: Princeton University Press, 1988); Barbara Ehrenreich, *Fear of Falling: The Inner Life of the Middle Class* (New York: Pantheon, 1989); R.H. Tawney, *Equality* (London: George Allen and Unwin, 1931); Richard Titmuss, *Commitment to Welfare* (New York: Pantheon, 1968); and Walter Korpi, *The Working Class in Welfare Capitalism: Work, Unions and Politics in Sweden* (Boston: Routledge, 1983).

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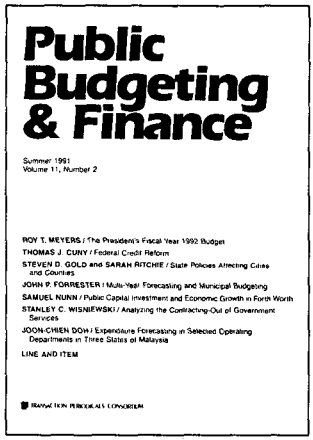
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David G. Green

MEDICAL CARE IN BRITAIN BEFORE THE WELFARE STATE

In Britain before 1911, the vast majority of the population provided medical care for themselves and had evolved a variety of schemes that checked the power of organized medicine and encouraged a steady improvement in standards. The evidence is that at the end of the nineteenth century about 5–6 percent of the population relied on the poor law, 10–15 percent on free care from charitable institutions, 75 percent on mutual aid, and the remainder paid fees to private doctors.

Is it true, as is so often assumed, that government has always been needed to help pay for medical care?

In Britain, medical care was provided in a variety of ways at the turn of the century. The very poor relied on the poor law, and provision for the rest of the population fell into three main categories. First, many sought medical care as private patients and paid a fee to the doctor of their choice. The fees charged varied according to income, with rent taken as the chief test of ability to pay. Second, a large section of the population obtained care free of charge through charities. Particularly in London and the larger towns,

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some people used the outpatient departments of the voluntary hospitals; others used free dispensaries where they existed. Third, and most common, were prepayment schemes, usually called contract practice, based on the payment of a fixed annual capitation fee.

Private Fees

The majority of the Royal Commission on the Poor Laws of 1909 found that "many," including those from the "poorest working class," paid fees as private patients in preference to joining clubs.[1] The Royal Commission had been told by the medical officer of health in Manchester that a very considerable number of persons earning less than 30 shillings a week paid ordinary fees.[2] And there is evidence that this had been so for many years. According to the *Association Medical Journal*, in 1853 "many" workers earning only 12s to 15s a week paid the customary private fee.[3] This is not as surprising as it may seem, for doctors charged fees according to income, and the lowest fee was within the grasp of the low-paid worker. Rent was usually taken as a rough indicator of means. An official tariff in *Whitaker's Almanack* for 1900 distinguished three scales: those paying rents from £10 to £25 a year; those paying £25 to £50; and those paying £50 to £100 or more. The minimum fee for a surgery consultation for the poorest class was 2s 6d.[4] In fact fees actually charged were much lower. In 1889 the fee for a surgery consultation varied from 1s 0d to 2s 6d. For a home visit (including medicine) fees varied from 1s 6d to 3s 6d. The most common fees were 2s 0d or 2s 6d, with 1s 6d charged for the very poor.[5]

Such fees, as long as they had to be paid only occasionally, were within the means of most wage earners. In 1906 the average wage of unskilled workers was about 22s a week; for the semiskilled, about 28s; and for the skilled worker, around 37s a week.[6] In addition, in some large manufacturing towns arrangements were sometimes made to pay fees by installments.[7]

According to the government's survey of 1910, many also turned to unlicensed medical practitioners. In 82 out of 217 towns studied, unlicensed medical practice was either increasing or taking place in large amount, and in a further 75 it existed to some extent. This included chemists who prescribed over the counter, herbalists, bonesetters, Christian scientists, faith healers, abortionists, and ve-

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nereal disease specialists. In mining areas such as Northumberland, Durham and Wales, bonesetters enjoyed equal standing with doctors.[8]

Free Care

Many poor people sought care from the voluntary hospitals and charitable dispensaries, which provided advice and medicine free to those on low incomes. These were available in most large towns. The system at the Newcastle free dispensary was that patients with a subscriber's letter of recommendation received attendance and medicine free, whilst "casuals" paid 2d for any medicine prescribed.[9]

Of greatest importance for the supply of free medical care were the outpatient departments of the voluntary hospitals. *Burdett's Hospitals and Charities* (1907) estimated that one in four of the population of London obtained free medical relief in 1877, one in 2.5 in 1894, and one in 2.1 in 1904. In 1887, for example, when the population of London was just over four million, there were 1.5 million outpatient attendances at London hospitals. In the same year there were also 162,000 consultations at 26 free dispensaries; 102,000 at part-pay dispensaries; and 126,000 at provident dispensaries run on benefit society principles for the whole family.[10] Using figures published by the Hospital Sunday Fund, Arthur Newsholme (later Sir Arthur) estimated the proportion of the metropolitan population obtaining free medical care in 1907 at one in four.[11]

Outpatient departments were important in the great majority of large towns, but the London figures are not typical of the country as a whole because of the heavy concentration of hospitals in the capital. Provincial figures varied. In Newcastle in 1894 the figure was one in two, in Edinburgh one in three, in Glasgow one in five, in Cardiff one in seven, and in Portsmouth one in 14.[12]

Contract Practice

The various types of prepayment schemes are identified in a report of the medico-political committee of the BMA, published in 1905.[13] Each type of contract practice was based on the principle of the flat-rate annual contribution, usually payable quarterly, entitling

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the contributor to any number of consultations during the period covered. Some such clubs were based at factories, others were organized by charities; some were run on commercial lines, some by individual doctors, some by local associations of doctors, and some by the friendly societies. By far the most important numerically were the friendly society schemes.

A number of doctors were employed by *works clubs*. Workers at a factory or mine arranged with their employer to deduct an agreed sum from their pay for the provision of medical attendance and medicines for themselves, and usually for their families. Some doctors were paid a fixed salary, others an annual amount per patient. In some cases the employer himself engaged a medical practitioner to attend his workers but by the turn of the century it was more usual for the selection of a doctor to be left to the workers themselves. The employees of a factory or mine chose their medical attendant in a general meeting and appointed a committee to manage the scheme. The most resilient of the works clubs were the "medical aid societies" founded by the miners and steelworkers of the Welsh valleys.

The *provident dispensaries* were semicharities, funded partly by the contributions of beneficiaries and partly by the charitable donations of the honorary members. These self-supporting dispensaries were often founded as alternatives to the free dispensaries, many of which had been established during the course of the eighteenth century. Free dispensaries were felt to create a permanently dependent section of the population; the provident dispensaries, by contrast, aimed to enable the poor to make as much of a contribution as they could afford, with the balance supplied by charity.

Beneficiaries paid a low annual contribution, thought to be within the means of the very poor, and the balance was supplied by the honorary members. The BMA acknowledged that many of those in provident dispensaries, private clubs, public medical services, and medical societies were "so poor" that they were unable to pay private fees at working-class rates. In rural districts, in particular, clubs were said to provide for the "thrifty but very poor."[14] The Leicester Provident Dispensary, one of the strongest, had 50,798 members in 1907 and ran a small maternity home and cottage hospital. Fees were a penny a week for adults, half for children; or threepence halfpenny a week for a man, wife, and all children under 14.[15]

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Some contract medical practice was organized on commercial lines by *medical aid companies*. The National Medical Aid Company, for instance, offered medical attendance as an inducement to obtain life insurance.[16]

The insurance companies were a valued alternative for the poor. While most of their customers had to pass a medical examination, some who contributed a very small sum could be admitted without a medical examination at the discretion of the insurance agent. The agents, who received a percentage of the premium income collected, had a strong financial incentive to admit such contributors, and by this method individuals who would have failed a friendly society or other medical examination were able to obtain the services of a doctor.[17] By 1905, however, the role of the insurance companies was being reduced due to legal pressure exerted through the General Medical Council (GMC).[18] A district medical officer in Birmingham told the Royal Commission on the Poor Laws that before the GMC had prohibited advertising and canvassing there had been a great many commercial medical aid companies, which the GMC rulings had driven out of existence.[19]

Among the great variety of arrangements made by the friendly societies for the supply of medical care, three proved most popular: the lodge system, medical institutes, and approved panels.

The traditional system in the large federations was for each *lodge* to employ a single medical officer. Usually the appointment was made by a free vote of all the members present at a general meeting. Sometimes doctors were invited to submit tenders before the election. In some areas several medical officers were appointed to a branch or a combination of branches, and the members then enjoyed a free choice among the available doctors. Sometimes medical officers were appointed at the pleasure of the branch, and sometimes for a fixed period of three months, six months, or a year.

From about 1869 a movement developed to found *medical institutes* to employ full-time medical officers serving the whole family. Groups of lodges banded together, raised funds, and purchased or rented premises. Organization was under the control of a committee of delegates which appointed one or more full-time medical officers, who usually received a fixed salary plus free accommodation. The medical officers' duties usually included general medical and surgical attendance, but not the dispensing of medicines. Dis-

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pensing was carried out by the medical institute's own dispenser to ensure use of the highest quality drugs.

By the turn of the century the *closed panel* system was growing in popularity. Friendly society members appointed doctors to an approved list. In Leicester, for instance, since the 1870s the societies had separated medical attendance from dispensing. By 1911 they had a board of 32 doctors who would attend and prescribe for all members. Members could choose freely among them.[20]

The National Deposit Friendly Society evolved a unique system which was much disliked by the British Medical Association, whose campaign against the scheme mirrored the early conflict between health maintenance organizations and the American Medical Association. Members paid flat-rate annual contributions, which entitled them to claim from the society a fixed proportion (usually two-thirds or three-quarters) of doctors' fees. The fee paid by the society was 2s 6d for a home visit, inclusive of medicines, and 1s 6d per surgery consultation.[21] In 1904 the BMA's medico-political committee recommended that no such system should be allowed to develop. They opposed it because doctors serving the National Deposit Society often accepted partial payment in full settlement of the account, which made it difficult for the BMA to achieve its aim of extracting the highest fee affordable by each income group.

There were also a large number of clubs organized by doctors themselves. Many of these *doctors' clubs* employed collectors to recruit new members as well as to call regularly for patients' contributions. The collector's commission was occasionally as low as 5 percent but sometimes reached 25 percent. Some doctors preferred to run their own medical clubs as a means of escaping the consumer control typical of the friendly society schemes, as this doctor's remarks to the British Medical Association's survey of 1905 reveal:

> The family club run by the doctor himself is a necessity. He can be dismissed at a moment's notice very often from a Friendly Society. The individual member of his own club, if he has a complaint to make, does it personally. The doctor is free from the supervision, and, as I have found, the impertinence of the committee of the Friendly Society. The patients in a family club look up to him personally. In the Friendly Society club he is very often treated as a servant. The smallest infringement of their rules means a complaint and a visit from the committee. The doctor of a family club can make his own terms.[22]

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Public medical services were rather like medical aid societies, but while the latter were controlled by lay committees, public medical services were "under the entire control of the medical profession." In 1905 public medical services were still a recent phenomenon. Usually they had been founded by the local branch of the BMA to combat provident dispensaries, medical aid societies, or friendly societies.[23]

Extent of Coverage

How many were covered by these arrangements? Of the 12 million originally included in the National Insurance scheme of 1911, at least 9 million were already members of self-administered mutual aid schemes.

It is difficult to arrive at a reliable estimate of the number of people relying on charitable care. Figures have already been quoted for the use of outpatient departments of voluntary hospitals. In London the figure was 25 percent of the population, in Newcastle upon Tyne, 50 percent, and in Portsmouth 7 percent. The data are not available to calculate a national average, but the figure was probably in the 10–15 percent range. However, people using outpatient departments would not necessarily have relied wholly on their local hospital. Evidence given to the Royal Commission on the Poor Laws of 1909 suggests that some also paid private fees from time to time and that some joined prepayment schemes, but were unable to keep up the contributions.

A more reliable estimate can be given for dependence on the poor law. In 1895 the Royal Commission on the Aged Poor reported on the reliance of the elderly population on poor relief. The commission produced figures showing reliance on the poor law by the "able-bodied" and the "not able-bodied," a category almost wholly comprising the elderly infirm.

The total number of paupers as a proportion of the population had fallen between 1849 and 1892, including the proportion receiving relief outside the workhouse (see Table 1).

The proportion of the "not able-bodied" had also fallen between 1862 and 1892, as Table 2 shows.

In another table the commission showed the number of people receiving poor relief on a single day, 1 January 1892. The total popu-

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Table 1: Receipt of Poor Relief, 1849–1892 (All Recipients)

Year	No. of Indoor Poor*	No. per 1,000 of Population	No. of Outdoor Poor*	No. per 1,000 of Population	Total (Indoor plus Outdoor)	No. per 1,000 of Population
1849	133,513	7.7	955,146	55.0	1,088,659	62.7
1852	111,323	6.2	804,352	44.7	915,675	50.9
1862	132,236	6.6	784,906	39.0	917,142	45.6
1872	149,200	6.6	828,000	36.3	977,200	42.9
1882	183,374	7.1	604,915	23.2	788,289	30.3
1892	186,607	6.4	558,150	19.2	744,757	25.6

*The indoor poor were those receiving relief in the workhouse, and the outdoor poor those receiving relief in their own homes.

Source: Royal Commission on the Aged Poor, 1895, *Report*, vol. 1, p. ix.

lation of England and Wales in 1891 was 29 million, of which 700,746 (2.4 percent) received poor relief on 1 January 1892. The figure includes those who received medical relief only. The commission also reported on the number of people who received relief at one time or another during 1892. The total came to 1,573,074, or 5.4 percent of the population.[24]

Thus, during the course of a year in the 1890s, about 5–6 percent of the population relied on the poor law, 10–15 percent on free care from charitable institutions, about 75 percent on mutual aid, and the remainder paid private fees.

Table 2: Receipt of Poor Relief by the Non Abled-Bodied, 1862–1892

Yr. (1/1 18–)	No. of Indoor Poor (Not Able-Bodied) (in 1000s)	Pct. Chg.	Ratio per 1,000 Pop.	No. of Indoor Poor (Not Able-Bodied) (in 1000s)	Pct. Chg.	Ratio per 1,000 Pop.	Total no. of Not Able-Bodied Poor (in 1000s)*	Pct. Chg.	Ratio per 1,000 Pop.
'62	53	–	2.6	340	–	16.9	394	–	19.6
'72	66	+22.1	2.8	369	+8.2	16.2	434	+10.1	19.1
'82	88	+33.8	3.3	270	−26.8	10.3	358	−17.6	13.7
'92	93	+5.5	3.2	258	−4.3	8.8	351	−1.9	12.0

*May not add precisely due to rounding in previous columns.

Source: Royal Commission on the Aged Poor, 1895, *Report*, vol. 1, p. x.

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The Consequences of the 1911 National Insurance Scheme

The friendly societies were so successful that their arrangements for social insurance and primary medical care formed the model for the early welfare state.[25] But this, ironically, was their undoing. The 1911 National Insurance Act was originally seen by Lloyd George, who steered it through Parliament, as a way of extending the benefits of friendly society membership to the whole working population. But on its way through the House of Commons the original bill was radically transformed as a result of pressure from the organized medical profession, which had long resented the dominance of the medical consumer and was equally anxious to obtain more pay and higher status for doctors.

The government proposal for national insurance, first published in 1910, brought about a change in the attitude of the medical profession. In 1903 contract practice had been described by the *British Medical Journal* as economically sound in theory and "in some forms . . . one of the pleasantest ways in which a medical man can earn his living."[26] But once public discussion of the proposals began, feelings changed. As one doctor put it, with compulsory state insurance the *raison d'être* of contract practice had gone: "We now resume our place as medical practitioners pure and simple, ready as sellers to give our services to the buyer, who is now not the poverty-stricken wage earner, but the solvent State Insurance Company."[27]

The friendly societies had for many decades encouraged doctors to improve the standard of their services through competition. In addition, the friendly societies evolved complaint procedures to keep doctors on their toes. The government provided complaint machinery under the 1911 Act, but it was much inferior. As Rudolf Klein has argued, the 1911 Act "marked a giant step forward in the emancipation of the medical profession from lay control." The complaints machinery of 1911 was introduced "not as an attempt to fortify the position of the consumer but as a salvage operation designed to save something from the wreck of lay control over medical services." This act was "the first rung in the ladder leading to the syndicalist system of professional control over the health services."[28]

The friendly society tradition was based on the rules of "natural justice." There were two main principles: *audi alteram partem*, "hear the other side"; and *nemo judex in causa sua*, "no man may be a judge

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in his own cause." Underlying this philosophy was the belief that both sides had an equal right to have their case heard and that essential to the process was the independence of those judging the issue. Friendly society rules therefore provided for the appointment of arbitration committees comprising individuals with no axe to grind.

The view of the doctors was the opposite: no one should judge professional conduct except professionals themselves. Doctors have often asserted that this notion is in the public interest, but without exception it has been accompanied by an ethos of professional loyalty that strongly discouraged criticism of one's colleagues.

The 1911 National Insurance Act weakened the power of the medical consumer and raised medical incomes. The leading complaint voiced by doctors before the 1911 Act was that they were underpaid. As a result of the government scheme, they secured a very large increase in their compensation. Initially the government had offered doctors 6s per insured patient, including medicine. This was a generous offer, for the minimum contract practice rate then being demanded by the BMA was 5s, itself higher than some market rates. In February 1912 the BMA demanded 8s 6d, excluding medicine.

Sir William Plender surveyed doctors' incomes in six towns, three selected by the Insurance Commission and three by the BMA. He reported that the average annual gross income of doctors was 4s 1¾d. The average annual capitation fee being paid was 3s 11d.[29] The *British Medical Journal* immediately denounced Plender's findings as biased and incorrect, and the BMA continued to press for an increase over the 6s being offered. The government responded by raising its offer to 7s 6d. This was also rejected. On 23 October the government finally raised its offer to 9s (including medicine). This offer was initially rejected by the BMA, but finally accepted in January 1913.[30]

In the years leading up to the 1911 Act the unity sought by many doctors was lacking. One of the chief results of national insurance was that it stimulated the medical profession to unite at the expense of the consumer. Doctors organized a campaign to transform the national insurance scheme into one that benefited them at the expense of medical consumers, and particularly friendly society members. As a result of their agitation between 1910 and 1912, the

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doctors made substantial gains: most notably, they freed themselves from lay control and nearly doubled their fees.

The Uninsured after National Health Insurance

The period from 1911 to 1948 is of particular interest because the working population was covered by the national insurance scheme, but wives and children were not. As a result, they found it necessary to rely largely on nongovernment health care services, thus allowing us to trace the evolution of nongovernment health care well into the modern era, and to gauge how the whole population might have fared if the state had confined its role to provision of a safety net rather than a public-sector monopoly.

The main types of provision continued to be: outpatient departments of the voluntary hospitals, free dispensaries, provident dispensaries, friendly society lodge practice, insurance against medical fees (including friendly society-approved panels), public medical services, private doctors' clubs, works clubs, and friendly society medical institutes.

Many people continued to use outpatient departments instead of a general practitioner, even though by the 1930s many voluntary hospitals were encouraging, or even requiring, patients to go to their GP first. In 1935 the 1,103 voluntary hospitals admitted 1.2 million inpatients and attended 5.6 million outpatients.[31] Some public hospitals performed a similar role.

Free dispensaries financed by charities continued to function in many large towns. In the mid-1930s there were over 20 in the London area alone. Provident dispensaries also continued to operate. In the London area there were nearly 20. The Battersea Provident Dispensary was one of the largest, with over 6,000 members in 1936. Single persons paid 3d a week, and doctors on its panel received a capitation fee of 6s.[32]

A number of private medical clubs continued to function, but it is impossible to estimate how many persons were covered. In the judgment of the BMA survey of 1938–39, private clubs were "gradually dying out." In the great majority of cases divisional secretaries reported that there were no private clubs, often because they had been absorbed into public medical services. Rates tended to be at least 3d a week, although local conventions varied enormously.[33]

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By the late 1930s, it is unlikely that more than 100,000 persons were covered by private club membership.

Many factories and all collieries provided medical attendance. Some were managed by the employer and some by committees representing employees. Usually such schemes covered families as well as employees. There were about 1 million miners in the mid-1930s. Their dependents must have accounted for between 2 and 2.5 million people.

The BMA had been promoting the establishment of "public medical services." The largest was in London, and by 1937 throughout the country there were nearly 80 services with 650,000 subscribers. A survey of 51 public medical services found that for each subscription 1.86 persons were "at risk." On this basis a total of about 1.2 million people were covered by public medical services. About 4,000 doctors were involved, receiving capitation fees averaging 11s 2d, with large towns more expensive than rural areas.[34]

Most of those who had been covered by lodge practice before 1911 were covered by national insurance, but the lodges continued to provide for the women and children who were outside the national insurance scheme. According to the BMA's 1935–36 and 1938–39 surveys of contract practice rates, contract practice for adult members of friendly societies was "steadily diminishing." But it was still to be found in many areas. Rates varied a good deal, depending on competition. In 1935–36, the annual fee in Bath was 5s; in Birmingham, 11s; in Chesterfield, 13s; Norwich, 12s; Kent, 6s; and in Barnsley, 10s. The highest was 16s, in Ely.[35]

Combining the BMA's findings with the figures published by the Registrar of Friendly Societies allows us to estimate the number of people obtaining medical care through the friendly societies. In 1930 there were 700 juvenile friendly societies with 185,000 members covered for medical care. In addition, the adult friendly societies had 261,000 junior members in 1930, making a total of 446,000 juvenile members. Of the total adult friendly society membership of 3,506,000, the great majority of female members would have subscribed for medical care. The Registrar did not publish separate figures for male and female members, but the evidence of the National Conference of Friendly Societies to the Beveridge committee of 1942 suggests that women comprised about a quarter of total voluntary membership. In 1941, 24 percent of the 4.6 million members were female.[36] Using this formula, of the 3.5 million adult

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voluntary members in 1930 around 840,000 would have been women. Most would have paid for medical benefits. Some of the male members would also have attended lodge doctors. If only 10 percent did so, it would suggest a figure of about 280,000. All told, at least somewhere in the region of 1.5 million persons, including children who were members of the adult friendly societies as well as special juvenile societies, must have been obtaining medical care through friendly societies (other than deposit societies) in the mid-1930s. This estimate is based on registered friendly society membership. In addition, there were probably an equal number of unregistered friendly society members.

After the 1911 Act some friendly societies developed new schemes for insurance against doctors' fees. Some medical schemes provided for repayment of the whole fee, and some for part. In most cases a doctor had to be selected from a panel of doctors who had agreed to charge specified fees.

Schemes run on part-payment principles (co-insurance) expanded rapidly. In 1936, over 1.3 million members of the National Deposit Friendly Society were covered for payment of a proportion of doctors' bills, as were 57,000 members of the Teachers Provident Society.[37] Until 1948, National Deposit Friendly Society members paid 2s 6d for a surgery attendance and 3s 6d for a home visit, including medicine. The society reimbursed either two-thirds or three-quarters of the fee.[38] However, according to the BMA, a "considerable number" of doctors continued to accept the National Deposit payment alone in full settlement of their bills, despite long-standing BMA criticism of the practice.[39]

In 1939 Great Britain had a population of 46.5 million. Of these, about 19 million were covered by national insurance. Outpatient departments of both voluntary and public hospitals must have served about six million; the charitable and provident dispensaries perhaps 300,000; the lodges 1.5 million; the medical institutes 150,000; fee-for-service insurance 2 million; public medical services 1.2 million; private doctors' clubs 100,000; and works clubs (including medical aid societies) about 3 million. According to these estimates about 14.2 million individuals would have been covered by the above schemes. It seems probable that at least another million would have been covered by unregistered friendly societies. The remaining 12 million or so would have paid private fees.

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The Relevance of Pre-Welfare Era

The skyrocketing cost of medical technology may make all of this information seem antiquarian, but matters are not necessarily so simple. By the time the National Health Service was founded in 1948, nongovernment organizations had adapted to changing technology—indeed they often pioneered it—for over 100 years. Because their evolution was prematurely halted by the intervention of the state, we can never know how they might have developed.

A host of goods and services have been revolutionized by technological advances during the twentieth century, but only because rising private incomes made them possible. It no more follows from the mere fact of technological advance in health care that, a priori, government provision is necessary, than that it is necessary for government to provide computers, automobiles, or air travel. Government does not somehow have access to resources that are not present in civil society. The state can no better afford to provide advanced medical care than can the taxpayers upon whom it depends for its revenue. Funds flow only from taxpayers; previously these funds flowed, not through government, but through private associations and especially mutual aid and charitable organizations.

It is commonly believed that the friendly societies were legacies of the preindustrial age, dependent on neighborhood ties that had broken down with the increased mobility brought by the industrial revolution. In fact, however, the largest societies were not a lingering relic of the rural age, but a *reaction* to industrialization. Until about the 1830s most societies were local, but from that period forward national societies with branches were established, based on fraternity rather than local obligation. By 1910 they had 2.8 million members.

Among other things, they organized an elaborate system of support for men who needed to travel in search of work.[40] The system provided not only for members to travel in search of a new job but also, if successful, to transfer to the nearest local branch. In the Ancient Order of Foresters, a society with over 600,000 members by the end of the nineteenth century, the member who had paid his contributions for a year was required to obtain a certificate (called a clearance) confirming that he was fully paid up. He then applied for a traveling license and, if granted, was given at least six checks

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worth 1s 3d (approx. 6p) and told the traveling password (which was changed every quarter).[41] The member would report to the local district secretary and, if able to give the password and offer the correct handshake, would be able to cash one check each day and two on a Saturday. The license could be valid for up to six weeks. If he found a job, the member could throw in his clearance to the local branch. The usual rule was that any member of 12-months standing who was clear on the books was entitled to a transfer. The clearance system operated internationally from early in the last century.[42] Migrants to Australia, New Zealand, Canada, and the United States, for instance, thus found themselves immediately among friends.

It is also said that the decline of religion has meant that we can no longer count on that goodwill of the rich toward the poor which underpinned the work of the charities founded to fill the gaps left by mutual aid. The real problem, however, is that by imposing a system of national insurance, governments supplanted other outlets for human idealism. Whether it is possible to hope with any realism that the future might bring a renewal of the ideal of serving others who are less fortunate, we cannot know. But the experience of this century indicates that when the state takes functions away from civil society, it diminishes the quality of human experience and suppresses openings for human idealism, as well as playing into the hands of organized producer groups at the expense of consumers.

As Charles Murray has argued, "Communities exist because they have a reason to exist," namely, "a core of functions around which the affiliations that constitute a vital community can form and grow." When the government takes away a core function, argues Murray, it depletes not only the source of the vitality of the function itself, but also the vitality of a much larger family of community responses.[43]

The rise of the welfare state has removed vital functions from civil society, and the history of one of these, medical care before the National Health Service, enables us to measure something of the potential we have lost.

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Alan Wolfe

WHAT EVER HAPPENED TO COMPASSION?

Marvin Olasky argues that compassion once meant a reciprocal relationship between those who provided charity and those who received it. This complex relationship has been undermined by the state's monopoly of welfare, which, in the name of compassion, eliminates people's sense of compassion. Olasky's insistence that private and public actions be analyzed in isolation from each other is unrealistic. The real question is what works and what doesn't. Americans need a way to use government to strengthen private institutions such as the family. Then we can find solutions to welfare problems that respond to practical, not moral and theological, concerns.

Debates over race, class, and poverty in America have increasingly become moralistic in tone. As fiscal and political constraints impose limits on how much money can be spent to relieve poverty, we argue more about the character of such programs than their size. Should the poor be held responsible for behaviors that perpetuate poverty? Ought we to make distinctions between the deserving and the undeserving poor? Should welfare be tied to the willingness of recipients to work or to stop having children out of wedlock? Is there an "underclass"? Even if there is, should we call it an "underclass"?

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Marvin Olasky, in *The Tragedy of American Compassion* (Washington, D.C.: Regnery Gateway, 1992), argues that we have been giving the wrong answers to these questions for about 30 years, although he sees recent signs that we may be becoming wiser in how we approach them. We went wrong, Olasky argues, when we began to give money to the poor with no strings attached. Private charity, which developed extensively in nineteenth-century America, got it right, Olasky claims. Then people understood that being poor was a condition that ought to induce a certain amount of shame. Religious figures, convinced that sins could be redeemed, were willing to help the down-and-out, but in ways quite different from current efforts. This is not only because such efforts were private and voluntary rather than public, but also because of the explicit moralizing associated with earlier efforts at relief.

Nineteenth-century charity was tied to a distinct set of beliefs about the reciprocal relationship between the giver and receiver of help. It was the obligation of a person providing charity to suffer with the person at the other end of the chain of obligation. This could be done through what Olasky calls the "seven marks of compassion." *Affiliation* and *bonding* are the first two. Charity workers would strive to find affiliated family and friends who could help. When all else failed, the social worker herself would bond with the applicant, serving, in a sense, as a surrogate family member. *Classification* was also crucial to the process; one wanted to know whether the recipient could work, had a history of good habits, and would be able to avoid alcohol and other forms of abuse. It was up to the volunteers to apply *discernment*, the ability to decide when someone was ready to re-enter the world of work and responsibility. Then followed *employment* and *freedom*, the ability to hold a job independent of anyone's charity. And all this was accompanied by a sense of religious purpose, that we are obligated to each other because we are all children of *God*.

This system worked, Olasky argues, far better than we realize from the perspective of the 1990s. Nonetheless, it was all but destroyed as the government monopolized the provision of welfare, starting with mother's pensions in the 1890s and ending with the liberal programs of the 1960s and 1970s. It is not so much the existence of a governmental monopoly over charity that is important, but the changed moral character that accompanied that monopolization. For now we no longer believe that compassion should be

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accompanied by any effort to "suffer with" the object of compassion. Welfare is now understood as a right. It has been divorced from any sense of religious obligation and any expectation of proper moral behavior. As the state increased its efforts to provide material rewards that were once provided by charity, social mobility decreased, private charitable organizations lost their turf, and marriage was undermined. Governmental bureaucracy, in short, replaced what was a dense and more personalized network of care. As it did, the true meaning of compassion was lost. The "tragedy" of American compassion is that the word is now used as a synonym for throwing money after problems, not as a term that exists within its own moral economy.

There is a Gresham's law with respect to charity, Olasky believes: the bad drives out the good. As a result, the poor, in his view, are worse off now than they were in the 1890s. Then, no matter how desperate their material condition, the possibility of upward mobility, pushed forward by a strong family structure, could not be ignored. Now the poor live in a far more hopeless state, victimized by efforts to help them. Unwilling to categorize, scornful of morality, refusing to judge behavior, we have consigned the poor to be perpetually harmed by their own pathologies. Our only hope is to return to nineteenth-century understandings, which some private charities—especially religious ones—have begun once again to do.

Olasky's targets in this book are those, such as Michael Katz and Frances Fox Piven, who have argued that being poor is a structural condition caused by a malfunctioning economy and not the result of private moral failings.[1] (He makes his points indirectly by documenting the naïveté of historical activists for social justice, especially ministers, who were quite appalling in their lack of realism). But *The Tragedy of American Compassion* is too ideological to create a convincing alternative to the views of Katz and Piven. Its black-and-white characterizations—private is good, public is bad; tough love is good, giving money is bad—are equally as problematic, especially concerning what life was like for the very poor in the nineteenth century.

It may well be the case that those who argue that all poverty in the 1990s is caused by structural economic conditions are exaggerating—although I have yet to see an effective refutation of William Julius Wilson's argument that the lack of available jobs

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within commuting distance of Chicago's inner city is the most important cause of the worsening condition of America's ghetto poor.[2] (Similarly, no account that I know of has countered the notion that poverty is directly related to residential segregation by race, as a recent study amply documents).[3] But even assuming that the structural explanation of poverty fails to account for contemporary conditions, does it follow that it also fails to account for historical poverty, especially the poverty around the turn of the century? This was, after all, a period in which the collective efforts of individuals to band together to improve the conditions of their lives were not permitted. One would never know from Olasky's account that private efforts to help the poor were a response to other private efforts which were causing poverty. The poor did try to help themselves; that was what unions were for. Far more individuals were raised out of poverty by the labor movement than were ever raised out of poverty by charity. And while conservatives may have claimed that unions were bad for people's character, that claim never stood the test of time. Capitalists got together with others to improve themselves; workers got together with others to improve themselves. Both wanted the government to stay out of their essentially private, but quite collectivist, activities. If Olasky is serious about private efforts to deal with charity, he should ringingly endorse the role of labor unions. He doesn't.

The state came into this picture relatively late in American history, when a number of people came to believe that neither the economic growth provided by capital nor the organizing ability provided by labor could ensure sufficient material rewards for everyone. So long as those who received assistance from the state were the lame, the blind, or the very old—or even, in Theda Skocpol's account, women and veterans—there was little opposition to a role for government.[4] But unplanned by almost anyone, government assistance eventually was rendered to those who might otherwise have worked, and that number in turn began to grow. While there are many who defend the growth of governmental benefits to all who claim them, liberals as well as conservatives have pointed out the problems as well: the inability of government to substitute for the role of fathers, the creation of a perpetual state of dependency, incentives that work against marriage, cheating, contempt for law, and inducements for crime. What has come to be called welfare is not very popular in America.

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Olasky's contribution to the critique of our welfare bureaucracy is original only in that it is more extreme than most. A general consensus around welfare reform would have the government play a role, but its role would be to encourage the institutions of civil society, including marriage and the labor market, to take up more of the responsibility for individual welfare. Very few people think we ought to go back to a system of private charity, for such a system, even if it insisted on moral character, could be demeaning in the extreme. That, at least, is what most people believe. If Olasky wanted to counter that belief, it seems to me, he might have established two points. First, he might have acknowledged that the historical picture is not completely benign. For all his eloquence about "suffering with," Olasky would have lost little with respect to his case—and he might have won over more skeptics—if he at least noted that even the best compassion can be condescending; who are you, a poor person might well ask, to be suffering with me? One can admit the flaws of purely private approaches to charity in order to strengthen the virtues, but Olasky's treatment is too ideological for such a balance.

But it is the second missing ingredient that is the most crucial. For Olasky's simple picture of the world—in which public is bad and private is good—fails to recognize that one is always dependent on the other. Private institutions such as the family must play more of a role in cultivating moral character, but families are strengthened or weakened by what government does. So are religious institutions and private charitable organizations themselves. Government can make the strengthening of civil society a priority or it can try to weaken the institutions of civil society. The relationship among family, church, voluntary association, and state is anything but zero-sum, as any military recruiting officer or inner-city educator can tell you. The real imperative raised by the welfare mess is to find out what works and to use it, not to insist on theoretical categories that have little relevance to real life.

We are desperately in need of welfare reform. Every country in the world, even in Scandinavia, is trying to figure out what some of those reforms might be. By insisting on the categories of yesterday's discussion, Olasky ironically strengthens those who want the state to monopolize the provision of welfare. If the choice is either-or, the state or private charity, I, for one, would choose the state. Fortunately, however, that is not the choice. The question is how

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can we use all the social institutions at our command—business, labor, family, neighborhood, church, and government—to create the conditions that enable people to take advantage of their human attributes. Olasky manages to avoid discussing all the hard questions of how we might do these things by ruling them out of order from the start.

American compassion ought to be a two-way street. We cannot ask the taxpayers to be generous toward the unfortunate without asking the unfortunate to understand the concerns of the taxpayers. But none of this is an argument against government playing a role in social welfare. Most countries have found ways in which public and private giving can support each other. American welfare policy, at its best, is flexible, experimental, and above all else, pragmatic in its combination of efforts. (For example, the emerging compromise notion that it is not wrong to ask people on welfare to train themselves for the work force represents a move toward the center from both the right and the left). Similarly, we ought to celebrate the willingness of Americans to give money and food to the homeless, not to condemn them, as Olasky does, for being insufficiently discriminating.

There may, in short, be another tragedy of American compassion besides the one about which Olasky writes, according to which every issue involving moral obligation is a struggle between the good and evil in man's soul. No thanks—I would rather discuss benefit levels and workfare. As appalled as Olasky is over rates of illegitimacy and self-perpetuating cycles of poverty, I think that realism demands, not that we preach sermons to the sinful—to which God should we appeal?—but that we struggle to find the techniques that can restore to our discussions of these issues some way to make American compassion workable. Public policy, as Max Weber once said of politics, should not be in the business of saving souls. It would be enough if it could create incentives to strengthen families and commitments to work.

NOTES

1. Frances Fox Piven and Richard Cloward, *Regulating the Poor: The Functions of Public Welfare* (New York: Pantheon, 1971); Michael Katz, *The Undeserving Poor: From the War on Poverty to the War on Welfare* (New York: Pantheon, 1989).

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2. William Julius Wilson, *The Truly Disadvantaged: The Inner City, the Underclass, and Public Policy* (Chicago: University of Chicago Press, 1987).
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4. Theda Skocpol, *Protecting Soldiers and Mothers: The Political Economy of Social Policy in the United States* (Cambridge, Mass.: Harvard University Press, 1992).

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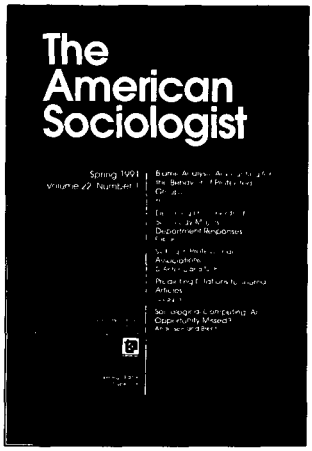

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David Miller

PUBLIC GOODS WITHOUT THE STATE

The provision of public goods is generally assumed to require compulsion by the state. Individuals may want them, but they have no incentive to contribute voluntarily to their production. David Schmidtz proposes "assurance contracts" as a way around the problem of "wasted" contributions. However, such contracts do not eliminate the incentive to free ride on public goods. Empirical evidence suggests that enforced contributions may be a more effective way of combatting this problem than assurance contracts. More generally, we need to investigate different kinds of moral motivation to see how they may elicit voluntary contributions of public goods.

If all philosophy is a footnote to Plato, then all political economy is a footnote to Adam Smith, so let us begin with the canonical text:

> The third and last duty of the sovereign or commonwealth is that of erecting and maintaining those publick institutions and those publick works, which, though they may be in the highest degree advantageous to a great society, are, however, of such a nature, that the profit could never repay the expence to any individual or small number of individuals, and which it, therefore, cannot be expected that any individual or small number of individuals should erect or maintain.[1]

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Smith cites as examples good roads, bridges, navigable canals, and harbors, but having asserted the principle that these should be provided from public revenues, he immediately goes on to argue that in most cases it is both feasible and desirable for the cost to be borne by the consumers of these goods. Why? Because he thinks that the sovereign power is likely to divert unattached revenues to benefit itself primarily and the public only secondarily. For instance, a bridge may be "thrown over a river at a place where nobody passes, or merely to embellish the view from the windows of a neighbouring palace."[2]

This sets the agenda for David Schmidtz's interesting and innovative book, *The Limits of Government: An Essay on the Public Goods Argument* (Boulder: Westview, 1991). His starting point is that public goods—goods that require the contributions of many to provide, but which once provided are available to contributors and noncontributors alike—really are goods, and that a society that fails to provide them is to that degree impoverished; to Smith's list we could add many more examples, particularly perhaps environmental goods such as uncongested roads, a pollution-free atmosphere, and the like. But, Schmidtz believes, if we see this as a reason for creating a political authority with powers that extend beyond those of a minimal state, we are opening the door to exploitation by those who control the reins of government. So the book explores the possibility of supplying public goods by voluntary means, without relying on coercion to force those who are unwilling to contribute to pay their share.

In posing the question in this way we have already passed two forks in the road whose existence I should record. First, Schmidtz accepts that there *is* a public-goods problem in the sense that there are goods that cannot be made excludable by establishing a suitable regime of property rights (roads are generally now a public good, but they could be made excludable by transferring them into private ownership and allowing owners to charge travelers for access; it is implicit in Schmidtz's position that solutions of this kind couldn't be made to work for public goods in general). Second, Schmidtz does not follow libertarians like Robert Nozick in allowing personal property rights to trump public benefits in all cases. In Nozick's view people have inviolable rights in the resources they own. If they choose to contribute part of these resources to provide public goods, all well and good. If they decline to do so, there can

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be no warrant for forcing them to contribute. Schmidtz leaves the door open here by distinguishing *teleological* from *emergent* modes of justification. An institution is emergently justified, he says, if it arose in the right kind of way—in particular, if it arose by universal consent. On the other hand, an institution is teleologically justified if it now accomplishes ends of the right kind, regardless of how it arose. So a state that provided public goods might be teleologically justified even if not everyone who is now required to support it has given their consent. Schmidtz thinks there is no reason to allow either of these modes of justification systematically to outweigh the other. It follows that rights cannot trump the enforced provision of public goods in every case.

What this boils down to is that Schmidtz, like Smith before him, has no principled objection to the public-goods argument for a more-than-minimal state. If certain public goods are valued sufficiently highly, if they cannot be provided without state enforcement of contributions, and if the state does now provide them by that means, it is justified in doing so. But because Schmidtz takes it for granted (he does not supply evidence here) that states are generally poor providers of public goods, he is motivated to look at the alternatives. More specifically, as we shall see shortly, he wants to recommend one particular device for eliciting contributions to public goods, namely, a conditional contract whereby, let us say, 1,000 individuals each agree to donate $100 toward providing a new wing for the local hospital on condition that the other 999 also donate; if $100,000 (the cost of the wing) is not raised, no one's contribution is collected.

To see what takes him to this solution, we need to look more closely at the nature of the public-goods problem. Like most theorists who have tackled this problem, Schmidtz begins by assuming that it is best understood as a multiperson prisoner's dilemma, although he later concedes that this is too simple. Let me illustrate the simple case. Suppose I have to decide whether to fit a catalytic converter to my car. The converter costs money, and, although fitting it would marginally reduce general air pollution, the benefit to me does not outweigh the cost. On the other hand, if all motorists fit converters the effect is dramatic and worth more to each of us than the cost of buying a converter. Unfortunately this will not occur voluntarily: each reasons that the private cost of fitting a converter is greater than the private benefit, whatever others do.

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The "game" is a classic prisoner's dilemma, and not fitting a converter is the dominant strategy in the sense that it is the rational thing to do whether you expect that other people will fit converters or expect that they won't.

This diagnosis provides the standard case for state enforcement, here in the form of legislation making catalytic converters compulsory. But before we reach that conclusion let us consider some other alternatives. Why might people in a prisoner's dilemma of the sort I have just described decide to cooperate voluntarily? One reason might be altruism. If I estimate the value of fitting the converter not by the benefit of the improved air quality it brings me but by the benefit it brings everyone, then it becomes rational to fit one. Schmidtz rules this out as a possible motivation for reasons that I shall come back to later. Another possibility is conditional cooperation. For this to work there has to be not just one but a series of "games" faced by the same group of people, so we need to vary the example a little. Suppose the choice is whether to burn my garden waste or compost it, and I value the outcomes as before (that is, I prefer burning the waste and putting up with my own smoke to composting the waste, but I prefer universal composting to universal burning). Suppose that the relevant "universe" is the group of 10 neighbors who live in my street and that we all garden on Sundays. Then it may pay me to cooperate conditionally in the sense that I will compost my waste provided others do too. More specifically I start off by leaving the waste to compost, and only set fire to it in subsequent weeks if some other neighbor has started a fire on the Sunday before. If everyone behaves like this, then the public good (a smoke-free environment) is provided voluntarily. It is rational to behave this way because the cost of lighting a fire is no longer just the smoke it immediately produces, but also the retaliatory smoke it will provoke from the neighbors.

This possibility, which has been explored in some detail by Michael Taylor,[3] is not considered at any length by Schmidtz. Given his interest in voluntary solutions to the public-goods problem, this omission is surprising, because conditional cooperation promises a solution that is purely anarchic in character. There is no need for any external sanctions to be applied to people who fail to contribute, because noncontribution generates its own sanction in the form of reciprocal noncontribution in the next round of the game. But the solution can only hope to work under certain fairly tight

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conditions, and it is perhaps awareness of this point that leads Schmidtz to look elsewhere. What conditions are these? The universe of participants has to be well defined, the same game has to be played repeatedly and without a foreseeable termination point, and the participants have to be responsive to one another's decisions in previous rounds. This leads Taylor to conclude that this form of voluntary provision is only likely to succeed in small communities whose members are interacting with one another on a regular basis.

How else might public-goods problems be solved without recourse to external enforcement? In introducing the prisoner's dilemma, I took a case where it is reasonable to suppose that the quantity of the good produced is a linear function of individual contributions. Each catalytic converter fitted removes so much exhaust gas and makes the air that much cleaner. But this is an extreme and unusual case. In other instances the marginal quantity of good provided by each new contribution will diminish—the first contribution buys the most, the second a fraction less, and so on. In still other cases the marginal contribution will increase up to a certain point, peak, and then turn down. This is likely to be the case for one of the examples Schmidtz uses, raising money for research into the cause of some disease, where the initial sums contributed won't purchase anything very worthwhile, then we get to a region where the effectiveness of the research unit steadily increases as new contributions are raised, until finally we reach a point where further expenditure will tend to duplicate what is already being done, and so the marginal value of a dollar contributed falls again. An extreme variant of this is a so-called step good whose nature is such that, let's say, $1,000 buys the whole good while $999 buys nothing at all. This will typically be the case where the good is a single physical item like a bridge or a work of art for public display—though even here the good is more likely to be multistep than single step in practice, in the sense that if donations totaling $1,000 allow you to build a wooden bridge, then perhaps $2,000 will get you a safer and longer-lasting stone bridge, and so forth.

Once we drop the assumption that the quantity of good produced is a linear function of individual contributions, we may also no longer be facing a straightforward prisoner's dilemma, even though we still have a public-goods problem. Depending on where my contribution would fit into the overall pattern of contributions, it may pay me in narrowly self-interested terms to make the contri-

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bution. To take the extreme case, mine might be the 1,000th dollar that gets the bridge built; less dramatically, my contribution to the medical research unit might be made at a point where an extra few dollars makes a big difference to the effectiveness of the research. So noncontribution is no longer a dominant strategy; instead the rational thing for me to do depends on my beliefs about what others have done (or are going to do). The game is no longer a simple one; it may be a prisoner's dilemma at some points and an "assurance game" at others (an assurance game is one where it is rational to contribute if others do so, and not if they don't).

There is another, quite different, reason why the provision of a public good may take the form of an assurance game rather than a prisoner's dilemma. In the examples I have just considered, the shift occurs because of the production characteristics of the good itself—the fact that there is no longer a linear relationship between individual contributions and the quantity of the good produced. There is a public-goods problem because people, not knowing how much of the good their own contribution would buy, may assume that the quantity bought will be worth less to them than the value of their contribution. But now consider another possibility. Suppose that people are imbued with a sense of fairness. When they benefit from the existence of a public good, they are prepared to make a contribution to providing it on condition that the other beneficiaries also contribute. In the simplest case, if there are n beneficiaries, each is willing to contribute $1/n$ of the cost of the good. Note that this attitude is different from the altruism that I mentioned above as another possible solution to the public-goods problem. The altruist is someone who attaches value to others' benefiting from public goods—a person who, when deciding whether or not to fit a catalytic converter, thinks not only of the cleaner air she will enjoy, but the cleaner air that Smith, Brown, etc., etc., will enjoy. The fair-minded person has a less-elevated outlook. He does not positively value others' enjoyment of public goods. But he is willing to "do his bit" or, in other words, is unwilling to be a free rider who enjoys a benefit without contributing his share of the cost.

For fair-minded people, public-goods problems typically take the form of assurance games. Each is willing to contribute provided she expects others to do likewise. The problem is to get someone to make the first move or, if the game is played simultaneously, to

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create a general expectation that the participants are going to contribute.

Assurance Contracts for Public Goods

With this apparatus now in place we can turn specifically to Schmidtz's proposed way of handling the public-goods problem. He recommends the use of an "assurance contract" whereby each potential contributor agrees to donate such-and-such an amount to finance a public good on the understanding that the donation is returned (or not collected) unless a certain specified target is met. Let us leave aside for the moment the question of how this contract is going to be established (suppose that its initiator is an altruist for whom the value of the public good exceeds the cost of collecting the pledges). Let us also assume that the beneficiaries of the public good can be readily identified, and, for the sake of simplicity, that they value it equally. On these assumptions, how might the contract serve to get the people in question to resolve their public-goods problem?

Schmidtz claims that the problem itself can be divided into two halves—the assurance problem and the free-rider problem. The assurance problem arises "if a person believes it would be futile to contribute because the [public] good will not be provided anyway." The free-rider problem arises because "an individual may feel that enough other people will cooperate to produce the good without her help. Hence, the individual may decide not to contribute, because she can enjoy the good for free" (56). He claims that the assurance problem can be solved by a loose form of contract, which returns people their money if a certain sum total is not raised, thereby assuring them that their contribution will not be "wasted." To solve the free-rider problem a tighter contract is needed which specifies that the good will not be provided at all unless each of the *n* individuals who benefit from it contributes. By making universal contribution a condition of the good's being provided, the opportunity to free ride is eliminated.

Implicit in these claims are some assumptions about the nature of the good being provided and/or the motivation of the beneficiaries, and it is a pity that Schmidtz does not treat these issues as clearly and systematically as he should. If we start, as Schmidtz does, with

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a good whose production is a linear function of the contributions made toward it, then no distinction can be drawn along the lines Schmidtz suggests between assurance and free-rider problems. No matter what other people decide to do, the incentive structure facing each individual remains the same: the value of his contribution to him is less than its cost to him. This is true whether he has to make his decision in advance of others' making theirs, or in the knowledge of what they have decided. It is quite misleading, therefore, for Schmidtz to say that, in a standard prisoner's dilemma, what deters a person from contributing is "her lack of assurance that enough others will follow suit to make her contribution worthwhile" (65). What deters her is simply the knowledge that her contribution buys her less (from a self-interested point of view) than it costs to make.

When he uses language like this (he talks frequently about "wasted" contributions), Schmidtz must either be thinking of goods with different production functions, or else he must be implicitly attributing different motivations to the contributors. Suppose we alter the production function quite radically by considering a single-step good like the bridge referred to earlier. This gives us a natural sense in which, if the contributions received add up to less than the $1,000 it requires to build the bridge, these contributions are "wasted" or not "worthwhile"; since they provide nothing, they are quite literally futile. Consider then this method of funding the bridge. A large box is placed in the main square, and people are invited to post dollar bills in the box with their names and addresses attached. As soon as $1,000 is raised the box closes and the bridge is commissioned; if less than $1,000 is raised, the bills are returned to their owners. This deals with the assurance problem as Schmidtz defines it: no one is in any danger of making a wasted contribution. But would a self-interested person decide to make a contribution in the first place?

The answer is "no" unless for special reasons the person in question thinks that he has a fairly high chance of being the person whose contribution makes the difference between $1,000 being raised and its not being raised, for this is the only circumstance in which the benefit of the contribution exceeds its cost. If the relevant group is large in number, this could only be the case under very special conditions. For instance if there happen to be exactly 1,000 people in the village and the bridge costs $1,000, then one

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might reason that the natural way of funding it was for each to contribute $1, and she would post this sum in the box on the grounds that if others defected she would get it back, while if no one else defected she would be the person who stopped the bridge from being built if she failed to contribute. But clearly this is a highly artificial situation. In more realistic settings self-interested people will hold back in the hope that others may provide the good.[4] If approached to sign an assurance contract (which formally is no different from being asked to put money in the box), they will simply decline to sign.

One could sum this up by saying that the money-back assurance (in whatever form it takes) blocks out one box in the prisoner's dilemma matrix (I contribute, others don't), but then the free-rider problem takes over and noncontribution remains the dominant strategy. Why does Schmidtz think that the assurance contract achieves more than it does? He presents two cases in which it would be effective. In one he simply introduces as a motivational premise that the individuals concerned are fair minded in the sense defined above: provided the relevant others contribute to the public good, they would rather contribute themselves than not contribute. With this premise the prisoner's dilemma is transformed into an assurance game, and then of course the assurance contract has the desired effect of making contribution into the dominant strategy. The other case Schmidtz cites concerns goods that can be made available only to contributors; here, as he rightly points out, the free-rider problem ceases to exist. But it does so because we no longer have a public-goods problem in the sense originally defined ("A public good, roughly speaking, is a good that can be produced only by collective action, but its production benefits people *regardless of whether or not they join in the collective effort*" [1, my italics]). Perhaps in a looser sense we could speak of a public-goods problem in the case of excludable goods that require joint contributions. But the point I want to stress is that where we have public goods in the strict sense (as defined by Schmidtz) and self-interested (not fair-minded) beneficiaries, an assurance contract is pretty close to useless as a means of eliciting contributions.

Having said that, I should immediately add a rider. There is one kind of assurance contract that *will* induce self-interested beneficiaries to sign up, and that is one that makes production of the good conditional upon *everyone's* agreeing to contribute. (This is the

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tighter form of contract that Schmidtz concedes is necessary to solve the free-rider problem; my point is that it is the only form that is effective at all given the original specification of the public-goods problem.) The effect of this contract is to put everyone in turn into the position of the pivotal contributor; each will sign because not to do so would immediately prevent the project from going ahead, while you are protected by the money-back guarantee if someone else should fail to sign. The problem for the organizer here is to convince potential contributors that she means what she says when she demands strictly universal contribution. Suppose she requires $1 each from 1,000 beneficiaries and she raises $950. Instead of handing the money back, why not provide the public good at a slightly lower level, but one that is still high enough to make each beneficiary better off on balance? Perhaps the good is one-step: it is $1,000 or nothing. But why not then go back to the 950, show them the pledges and ask each for an additional five-and-a-bit cents? ("One last push"; of course this assumes that the bridge is worth at least $1.05 to each person.)

Schmidtz's way out here is to insist that the contract should be adhered to; if $1,000 is not pledged, then no one's money is collected and the project falls. But even if formally speaking everyone is entitled to keep their money when only $950 is raised, there is nothing to stop the organizer (who we are assuming is altruistically interested in seeing the bridge built) from making one of the two proposals outlined above ("You can have your money back, but why don't we build this slightly cheaper bridge instead?"; "We nearly made it; can't we each find the extra 5 cents it takes?"). A rational beneficiary, when first approached, may reason: My holding out may invalidate the contract this woman is waving, but if enough others have signed up they'll find a way round it; and if they haven't, well, the project would never get off the ground in any case.

It is of course possible in a practical case that the project would collapse if less than 1,000 were to sign up. One reason might be spite on the part of the organizer ("I'm going to all this trouble; if they're not willing to put in a miserable dollar each, I'm not going to bother any more"). Another reason might be resentment on the part of those who have signed up ("It's everyone or no one; why should those people enjoy the bridge for free?"). But these are motivations imported from outside the original specification of the

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problem, which assumed that the individuals involved were rational and self-interested.

So, to sum up, a strict form of assurance contract will solve the public-goods problem in its original form *provided* it is possible to convince the potential contributors that there is no alternative waiting in the wings (and I have suggested this is going to be very hard to do); while looser forms are effective only if we rewrite the original terms of the problem (e.g., by assuming that people are "fair-minded").

The difficulties we have observed are compounded once we take into account the possibility of "honest holdouts," as Schmidtz terms them. These are people who may enjoy the good when it is provided, but who can genuinely claim that it is worth less to them than the proposed cost of contribution. Since they have no good reason to sign an assurance contract, anyone hoping to organize one has to exclude these honest holdouts; but how is one to tell whether a given person belongs in this category or is merely trying to free ride on a good that is worth at least the proposed cost of contribution to him? Unless honest holdouts display some external distinguishing mark, their presence dooms the strict assurance contract, and we are back with the looser form of contract with its very limited potential.

Experimental Evidence on Assurance Contracts and Enforced Contributions

We need to look, too, at the motives of those who might try to organize an assurance contract. But before doing so, I want to examine the evidence that Schmidtz produces in the sixth chapter of his book about the effectiveness of assurance contracts as a means of getting people to contribute to public goods. Even if such contracts won't work in theory, they may in practice, because people may not behave in the rationally self-interested way that game theory assumes. Indeed when people in experimental settings are put into prisoner's dilemmas, they sometimes behave cooperatively, in defiance of what game theory would predict.[5] So it makes sense to ask whether *in practice* assurance contracts are an effective way of getting people to contribute to public goods.

These experiments take the following basic form. A group of

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people, artificially created for the experiment, is given a small sum of money which each individual can either keep for himself or donate to a common pool; if he donates the money it is increased in value and distributed equally among all members of the group. Obviously, if everyone donates each member of the group ends up better off, but the individually rational thing to do is to keep the cash. The design can be varied in a number of ways: the multiplier effect of donating can be bigger or smaller; the size of the group can be varied; the game can be played once or as part of a series (thus allowing the possibility of conditional cooperation); thresholds can be introduced such that the enhanced payoffs only occur if more than $X is donated; and so forth. In this way we may be able to isolate the factors which, either for rational or nonrational reasons, tend to encourage contributions in public-goods settings.

Schmidtz's experiment took the following form: six groups of four individuals were formed and they were asked initially to make donation decisions subject to the following three thresholds; in the first case, the group payout occurred only if each member donated all his cash (otherwise contributions were lost); in the second, the threshold was set at about 87 percent of the group's resources; in the third, it was set at about half this level (ca.43.5 percent of the total).[6] With each group the experiment was run 10 times. In general there were quite high levels of donation in early rounds, but these fell off as members came to believe (presumably) either that contributing to the group was pointless, or that they could free ride on others' donations which would take them over the threshold. With each threshold, one group out of six managed to stay above the threshold throughout; the remaining five fell steadily below, in some cases declining to a consistent contribution level of zero.

The experiment was then modified by introducing a money-back guarantee. If a group failed to meet its threshold, those who had donated would have their cash returned intact. How does this alter the decision each member must take? There is no longer any risk of losing your money by contributing; on the other hand, if you think the group is going to pass its threshold without your donation, then you do best by holding back. The new experiment corresponds to Schmidtz's assurance contract. With the top threshold it corresponds to the tight form of contract I discussed earlier, because the group benefit is not provided unless everyone donates all his cash. With the two lower thresholds it corresponds to the

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looser form of contract where universal signing is not required, and where individuals can hold back in the hope that enough others will sign up to provide the public good.

With the top threshold and money-back guarantees in place, it is rational for each person to donate all his cash: he risks nothing by doing so, and this is the only way to get the group benefit. In four out of six groups, members realized this and universal donation set in (there is not much point in speculating about what happened in the other two groups, though see p. 123 for Schmidtz's observations on this point). The more interesting question is what difference introducing the money-back guarantee made with the other two thresholds in place. At the 87 percent point it made a fairly substantial difference; contributions stabilized at an overall level very close to the threshold, and groups received their payoff on 32 occasions out of a possible 60 (as compared with 15 times out of 60 without the guarantee). At the 43.5 percent point the difference was much less impressive. Contributions tended to tail off as the sequence of games progressed, as participants presumably began to think that the threshold could be reached without their donations (payoffs were achieved on 26 occasions out of 60, as compared with 21 out of 60 without the money-back guarantee). Notice that with the 87 percent threshold and a four-member group, contributing *something* is a dominant strategy. The threshold cannot conceivably be reached unless everyone puts some money into the common pool. The question is how much to put in: 60 percent? 80 percent? 100 percent? Whereas with the lower threshold half the group can contribute nothing and it would still be possible for the threshold to be reached with high donations from the other two members.

If we allow that general conclusions can be drawn from artificial experiments like these, the moral seems to be that money-back guarantees are effective at raising the level of contribution only when the cut-off point is close to the ceiling. At this point people will feel that by giving a donation without a guarantee, there is a relatively high risk of wasting their money, whereas opportunities for free riding are limited. At a lower cut-off point there appears to be a much better chance that others will fork out to provide the good, and a money-back guarantee will have a double-edged effect: it may still ensure that no donation is futile, but insofar as it encourages others to contribute for this reason, it increases *my* chance of getting the good for free.

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Besides reporting on the experiment in which he was involved, Schmidtz also discusses a second experiment which was designed to *compare* the effectiveness of the money-back guarantee as a way of escaping prisoner's dilemma problems with an alternative device: enforced contributions.[7] This worked in the following way: *provided* sufficient donations were made to take the group above its threshold, matching contributions were extracted from the members who had failed to contribute; on the other hand, when the threshold was not reached, those who chose to donate lost their donation. Here, then, free riding is impossible, but there is still a question as to whether it is worth donating to help get the group over the threshold. In the experiment in question, using seven-person groups, the money-back guarantee had rather little effect on rates of donation, whereas enforced contribution was quite strikingly effective, raising rates of contribution close to 100 percent. The authors of this study conclude that the guarantee mechanism tends to fail because expectations of its success undermine that success, whereas by contrast "enforcing a contribution if a public good is provided works to promote contribution by convincing people that the good will be provided and by removing the opportunity for free riding if it is provided."[8]

How does Schmidtz respond to this challenge? Some of his discussion turns on specific features of the second experiment, which he claims worked in favor of enforced contribution; it would not be profitable to pursue these detailed issues here. But he also makes one general point which is worth considering: even if enforced contribution is effective, it is not a voluntary mechanism for providing public goods, for it depends upon seizing contributions from beneficiaries of these goods who have chosen not to contribute. And, he asks, "How do we get that kind of power, and what gives us the right to use it in that way?" (115).

I think these questions are misplaced, given Schmidtz's original concession that institutions might be justified teleologically (in terms of what they achieve) as well as emergently. He is a Smithian, not a Nozickian, as one might put it. Enforced contribution as a method for providing public goods does seem to get around the original objection to state provision, namely, that if the government decides which public goods are to be provided, it will tend to supply those that disproportionately benefit its members or its clients. Under the enforced fairness system, no good is provided

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unless sufficient beneficiaries contribute to its provision. The role of public enforcement is only to prevent other beneficiaries from free riding on the backs of those who volunteer to contribute. The choice of goods remains with the public, not with the government; Smith's inconvenient bridge would not get built under this system because too few people would offer to contribute to get past the threshold.

It might be said in reply here that a government agency must set the threshold in the first place, and must also be responsible for defining the set of beneficiaries who would be subject to the enforced contribution rule. This leaves the door open to manipulation in the interests of the state. This reply is valid, but we must take care that we are comparing like with like. If we ask how enforced fairness would work in practice, we must also ask how assurance contracts might work. Up to now I have been abstracting from that problem by envisaging an altruist who makes it her business to organize the contract. But if we start from Schmidtz's premises (which discount altruism), a more realistic assumption would be that assurance contracts would be arranged by entrepreneurs who would in effect charge a fee for getting various public goods supplied. But an entrepreneur would also have interests outside of the contract and might, for instance, want to make sure that the bridge was built conveniently close to his mansion. Why should we expect any less distortion in the set of public goods supplied by entrepreneurial means than in the set supplied by state officials, particularly if we are willing to require the latter to use demand-revealing techniques, such as that suggested by the enforced fairness system? Here it may be said that public-goods entrepreneurs are subject to the usual constraints of market competition, so that if an entrepreneur arranged a contract to supply a public good that was obviously biased in his own favor, he would be outflanked by a second entrepreneur who came forward with a more appealing contract, and so on. In theory this is so. In practice it is hard enough to envisage how an assurance contract system might be workable at all, let alone to imagine a market in assurance contracts (recalling here that, as our analysis has shown, such contracts are likely to be effective only if they succeed in identifying and attracting practically all the beneficiaries of a proposed public good).

Further a priori speculation along these lines is not likely to be fruitful. If we are going to make a reasonable comparison of public

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and private means for supplying public goods, we need empirical evidence about the relative performance of state agencies and private organizations in this sphere. Not possessing such evidence, I should like to conclude this review with some remarks about general strategies that are available for solving the public-goods problem.[9]

Morality as a Solution to the Public-Goods Problem

These strategies fall broadly into three classes: those that rely on individuals' *interests*, those that rely on *compulsion*, and those that rely on *morality*. For most of the time Schmidtz's strategy is of the first kind. The assurance contract is a way of getting individuals who have an interest in a public good's being provided to act on that interest by contributing (although as we have seen, he does from time to time switch horses by appealing to fair-mindedness). The standard view which he is opposing relies on compulsion. Seen on its own terms, the more-than-minimal state is a device whereby individuals who want to have public goods provided can arrange to do so by mutual compulsion. But there is a third possibility: individuals may contribute to public goods because they believe they morally ought to do so. This is an attractive possibility, because it seems to promise a voluntary solution to the public-goods problem shorn of the difficulties that we have seen attend Schmidtz's interest-based solution.

I have already distinguished two forms of morality that are potentially relevant to the public goods problem; I called them altruism and fair-mindedness. Fair-mindedness is close to what Schmidtz in his last chapter calls reciprocity, the idea that one should behave cooperatively if and only if others do too. Schmidtz, like others before him, explores the idea that reciprocity can be a refined form of self-interest, in the sense that someone who practices it will in general tend to fare better than someone who acts out of unrestrained self-interest on all occasions. I want here to pursue a different question: why might either of these moral attitudes successfully motivate the production of public goods?

At first glance it looks as though altruism—caring directly about the welfare of people besides yourself—would give us the best possible basis for public-goods provision. Schmidtz's objection is

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that altruism is unstable because if there are a few nonaltruists in the population, they will be able to free ride on the benevolence of the remainder, and this will then encourage others to behave likewise to avoid being exploited. This boils down to the claim that altruism is not a deep-seated moral attitude, but one that is dissipated by the sight of other people behaving nonaltruistically. I want to focus on a different problem. Altruism comes into its own where there is some good to be provided and an obvious agent to do the providing—where I alone am endowed with some resource that a group of people need, for instance. In most public-goods cases the position is different: there are n beneficiaries and m possible providers, where perhaps $m = n$. Altruism alone does not determine who should do the providing or how the burden should be distributed. So people may be altruistically motivated and yet not contribute, because they do not have sufficient reason to take the practical step that would help to get the good provided. Every bystander may genuinely care that the person who has collapsed in the street should be helped to hospital, yet each may hold back in the hope that someone else will take on this somewhat burdensome task.

Fair-mindedness may be a more prosaic moral attitude, but it avoids the above problem, or at least it does so if the relevant group can be identified, and if it is reasonably obvious what "doing my fair share" consists of. It need not be defeated by the observation that different people benefit to different degrees from any particular public good, because it may be possible to treat a range of goods as a package and apply the fairness criterion to the package as a whole. The biggest problem may be establishing a high enough level of trust, so that people are ready to make their contribution with a reasonable degree of assurance that others will do likewise when the occasion arises.

One important factor here is *communication*. There is some experimental evidence drawn from the same stable as Schmidtz's which confirms this point.[10] A seven-person group was placed in a standard prisoner's dilemma where once again the choice was between keeping cash in individual accounts or donating it to a common pool whereupon it would be doubled in value and shared equally among the seven members. The relevant finding was that allowing a 10-minute discussion period within the group pushed up the rate of contribution from 37.5 percent to 78.6 percent. It is not clear

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exactly what mechanism was at work here. The authors suggest that the discussion period allowed the individuals involved to make promises to one another to contribute, but they also allow that one could explain the outcome in terms of a group identity that emerged through the process of discussion. For present purposes it is not important which interpretation is closer to the truth. The significant point is that communication within the group created an atmosphere of trust in which members felt able to donate most of their resources to the common pool with a reasonable expectation of reciprocation. It is also worth noting that this cooperative disposition was confined to the group itself: discussion failed to persuade members that they should make an external donation to a second group working alongside the first (thus it was not general altruism that motivated contribution).

I believe that if we want to find voluntary solutions to public-goods problems, this is the direction in which we should be looking. Under what circumstances will people interact with one another in such a way that they identify with and trust one another, and are then ready to apply norms of fairness when a contribution is requested? This is a more promising avenue than devices such as the assurance contract, which essentially rely on self-interested motivations. Of course the conditions supporting fairness may not be realized, and then the assurance contract may play some role (in fundraising among a mass public, for instance). But, in general, morality is a better basis for the voluntary production of public goods than self-interest, however artfully it is tailored.

By the direction that the argument takes in his last chapter, Schmidtz reveals that he too recognizes this point. His thesis is that reciprocity—cooperating if and only if your partners cooperate—puts social relations on a sounder footing than either naked self-interest or unconditional altruism. One may agree with the thesis without endorsing the explanatory claim that underlies it, namely, that the superiority of reciprocity resides in the incentives that it provides *other* people to cooperate. Moral norms do not require this kind of support. Adam Smith, though justly famous for his remark that self-interest is the best way of getting us our meat and drink, was also clear that a large segment of social life was governed by norms of propriety that could not be explained reductively by appeal to personal interests. This is a lesson to be taken to heart by those who share his skepticism about state activity. Schmidtz's

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book advances this discussion, and it does so by encouraging us to think afresh about the relative merits of different ways of supplying public goods.

NOTES

1. Adam Smith, *The Wealth of Nations*, vol. 2, ed. W. B. Todd (Oxford: Clarendon Press, 1976), 723.
2. Ibid., 725.
3. Michael Taylor, *The Possibility of Co-operation* (Cambridge: Cambridge University Press, 1987).
4. At least if they are *rationally* self-interested. There is some evidence that people in practice tend to overestimate the causal efficacy of their own personal contributions to public goods. This may be because they indulge in what Jon Elster has aptly referred to as "magical thinking": each thinks that if she contributes, this fact makes it more likely that others who are similarly placed will contribute too. (See Jon Elster, *The Cement of Society* [Cambridge: Cambridge University Press, 1989], 195–202). So by contributing I somehow bring it about that more than my own individual contribution is raised. For evidence of this exaggeration of personal efficacy, see Edward N. Muller and Karl-Dieter Opp, "Rational Choice and Rebellious Collective Action," *American Political Science Review* 80 (1986): 471–87. For the reason why contributing to collective goods on the basis of such overestimation cannot be called rational, see George Klosko, "Rebellious Collective Action Revisited," *American Political Science Review* 81 (1987): 557–61.
5. See, for instance, G. Marwell and R. Ames, "Experiments on the Provision of Public Goods. I," *American Journal of Sociology* 84 (1979): 1335–60; idem, "Experiments on the Provision of Public Goods. II," *American Journal of Sociology* 85 (1980): 926–37.
6. See R. Mark Isaac, David Schmidtz, and James M. Walker, "The Assurance Problem in a Laboratory Market," *Public Choice* 62 (1989): 217–36; as well as Schmidtz, *The Limits of Government*, ch. 6.
7. Robyn M. Dawes, John M. Orbell, Randy T. Simmons, and Alphons J.C. van de Kragt, "Organizing Groups for Collective Action," *American Political Science Review* 80 (1986): 1171–85.
8. Ibid., 1183.
9. For a more extended discussion, see especially Elster, *Cement of Society*.
10. John M. Orbell, Alphons J.C. van de Kragt, and Robyn Dawes, "Explaining Discussion-Induced Co-operation," *Journal of Personality and Social Psychology* 54 (1988): 811–19.

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David Schmidtz

MARKET FAILURE

The Theory of Market Failure *explores how markets respond, both in theory and in practice, to public-goods and externality problems. Most of the articles in this anthology find that markets often meet the demand for public goods in a variety of cases where existing theory would lead one to expect market failure. Moreover, upon reflection, existing theory reveals itself to be in need of supplementation by a more realistic picture of how flexible markets (and evolving systems of property rights) respond to the demand for public goods and for the means of internalizing externalities.*

"The assertion of market failure is probably the most important argument for governmental intervention. At one time or another nearly every sector of the American economy has been branded as a market failure. Such assertions are usually based upon the theory of public goods and externalities" (1). So begins Tyler Cowen's introduction to *Public Goods and Market Failures* (New Brunswick, N.J.: Transaction, 1992). As Cowen uses the term, an externality occurs whenever one person's actions affect the utility of another (2). An externality is a divergence between an activity's private cost (the cost borne by the agent) and its social cost (which includes the cost borne by others). A public good, in turn, involves two elements: nonrivalry in consumption and nonexcludability. Consumption

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exhibits nonrivalry insofar as one person's ability to enjoy a good is not diminished by allowing others to enjoy it as well. The good's consumption is nonexcludable insofar as others cannot be prevented from enjoying it. Thus, one who produces a nonexcludable good generates a positive externality (i.e., a divergence between private and social *benefit*), for others will be able to *free ride*, that is, to enjoy the good without paying for it. All of this is explained very nicely in the opening pages of Cowen's introduction to this excellent collection.

If those who benefit do not have to pay for the benefits they receive, then they will not in fact pay—at least, so the theory goes. This is a problem, the theory continues, because if the free riders had invested a bit of their own money in the project, everyone might have been better off. Therefore, government ought to get involved, financing efficient levels of public-goods production through an equitable fundraising mechanism.

There are a few gaps in this argument, of course. Part of the burden of Cowen's anthology is to show that some of these gaps are *big*. If the market-failure argument is to produce a justification for government intervention in the market, it must establish a number of separate points. It must show that markets actually do fail, not only in theory but in practice. It must also show that under the conditions in which markets fail, government intervention works better, not only in theory but also in practice. It is the former set of questions, having to do with market failure, on which the Cowen anthology concentrates. The anthology explores the extent to which market forces can and do prevent market failure. The selections range from early technical presentations of the problem by Samuelson and Bator to recent case studies of the private supply of such goods as fire protection and education.

Kenneth Goldin's paper ("Equal Access vs. Selective Access: A Critique of Public Goods Theory") explains that nonexcludability is not an intrinsic feature of goods that are provided as public goods. Rather, the extent to which consumption is excludable is a function of the chosen method of provision. Thus, for example, some interstate highways are freeways and others are toll roads. Generally speaking, however, there is nothing in the nature of the various highways that dictates which ones will be freeways and which will be toll roads. Rather, the degree of excludability is determined exogenously. Should there be a compelling reason to

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provide equal access rather than selective access to a particular good, the specter of free-rider problems arises, but these problems may or may not be worth solving. Just because we would otherwise have free riding does not entail that coercion would be worth its cost.

The paper by Earl Brubaker ("Free Ride, Free Revelation, or Golden Rule?") notes that private entrepreneurs wishing to provide public goods on a for-profit basis may find that their prospects depend not only on the chosen method of provision but also on how well they handle the process of negotiation leading up to the good's provision. Providing a good by a method that allows free access normally does not accord with sound business principles, of course. Even so, should there be compelling economic, moral, or aesthetic reasons to provide the good by a method that allows free access, the entrepreneur may still turn a profit. He can make use of a kind of preproduction excludability simply by refusing to produce the good until a suitable cost-sharing agreement is reached. We might envision a situation wherein a group of people want to hire the entrepreneur to pave the roads in their community. The entrepreneur then agrees to undertake the paving if and only if a specified number n of community members each contribute a specified amount.

Cowen refers to the case where the entrepreneur can truly commit himself to providing the good only if this condition is met as a "limiting case" (7). Although this is not spelled out, I believe the worry here is that as the number of contributors approaches n, there will be a point at which would-be free riders will come to believe that the entrepreneur has already collected enough to assure himself a profit. Thus, if he threatens not to go ahead without the full measure of n, they will believe that he is bluffing and that if they call his bluff, he will eventually give in and undertake to provide the paving for less than the agreed-upon sum. And they may be right. I doubt there is a real problem here, however, for if one wants to ensure that the entrepreneur has no choice but to stick to the original terms of the agreement, one need only stipulate as a condition of the contract that no one's pledge is collectible until the entrepreneur has kept his side of the deal, his side being to secure the full measure of n pledges from members of the community. This will ensure that the entrepreneur has no temptation to proceed with less than the specified amount. Indeed, the point is that he will

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not even have the opportunity to proceed with less than the specified amount, for the contract prohibits him from doing so. (Side payments from the entrepreneur to reluctant contributors would have to be ruled out, but this is the general idea.)

We should note here that the free-rider problem is only one of the behavioral problems that might plague people trying to negotiate the production of public goods. There is also an assurance problem, which is the worry a contributor might have about ending up having sunk money and effort into a venture that never acquired enough capital to get off the ground. Brubaker believes that the latter difficulty is a big one and that solving it would end the public-goods problem to a large degree, even if the free-rider problem remained unsolved. Note that even if Brubaker were wrong about this, the idea of preprovision excludability would remain important, because entrepreneurs as well contributors can have assurance problems. The entrepreneur's assurance problem is solved by preprovision excludability, however, for he need not begin to buy equipment, hire workers, and so on until he is as sure as he feels he needs to be regarding the venture's solvency.

In any event, Brubaker's main hypothesis is that the preprovision excludability factor can induce nearly optimal levels of voluntary contributions. This hypothesis is testable, and Brubaker concludes his article by proposing an experiment. I might note here that recent experiments by Isaac, Schmidtz, and Walker seem particularly relevant to Brubaker's hypothesis. In particular, the results of our experiments show that voluntary contribution levels tend to be dramatically higher when a provision point (below which the good will not be produced) is arbitrarily imposed and subjects are offered a money-back guarantee in the event that the provision point is not met by the group's total contributions. It seems to me that this result strongly supports Brubaker's hypothesis.[1]

Further attempts to relate theory to practice are found throughout the book. For example, classic papers by Ronald Coase ("The Lighthouse in Economics") and Steven Cheung ("The Fable of the Bees: An Economic Investigation") ponder historical evidence of flourishing practices of public-goods provision by private sources, in particular discussing lighthouses and pollination services, respectively. Robert Poole ("Fire Protection" and "Leisure and Recreational Services") discusses the wide variety of services provided by local governments that could be handled just as well by private

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concerns. So the hypothesis that people will free ride whenever they have the opportunity has been shown to be false both by history and by controlled experiment. The trick now is to determine what makes people contribute voluntarily, and how best to capitalize on those factors when designing mechanisms for soliciting voluntary contributions to public-goods projects.

A selection from Robert Axelrod's book, *The Evolution of Cooperation*, formally presents the two-person prisoner's dilemma as an example of a strategic situation that can lead to market failure even in two-person groups and even in situations involving only excludable goods. (At least, I infer that this is the point of including the Axelrod selection here. Many theorists believe that the many-person prisoner's dilemma game structure is what underlies public-goods problems in general, but Axelrod discusses only two-person games in this selection.) The fact that defection is a dominant strategy in this game leads Axelrod to say that mutual defection is the expected outcome when played by self-interested players. The prospect of repeated play holds some promise, for players involved in repeated play have a reason to cooperate with each other, stemming from the fact that if they defect, they will be victims of retaliatory defection in subsequent play. An interesting problem arises, however, if the game is to be repeated a known and finite number of times. The problem is that backward induction arguably will lead to mutual defection despite the prospect of repeated play. The idea here is that in a finitely iterated prisoner's dilemma where players know when the game will end, rational players will automatically defect in the last period, for at that point there will no longer be an ongoing relationship to worry about. And since they foresee that everyone will automatically defect in the final period, they may as well defect in the second-to-last period too, since there is no hope of carrying the cooperative atmosphere into the final period. The logic zips back, implying that the only rational strategy is to defect right from the start. Thus, for example, a firm may have very cordial relations with its suppliers, but if it announces that it is going out of business at the end of the month, it may immediately lose the ability to do business on a credit basis, for there is no longer the benefit of a long-term future relationship to discipline present interactions.

How might we avoid this truly dismal result? One escape from the backward induction paradox emerges if, in a game between

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you and me, I come to the game with an established reputation for always responding to my partner's moves in kind. If you think I will live up to my reputation, then the rational strategy for you is not to defect from the start, but rather to cooperate until the game is nearly over, in order to elicit the maximally cooperative response from me.[2] This holds even in ordinary finitely repeated games, as long as players can have previously established reputations going into the game.

Moreover, the real-world situation is not so much an iterated prisoner's dilemma as it is what I call a *concatenated* prisoner's dilemma, meaning that as one iterated prisoner's dilemma game comes to an end, the players (buyers and sellers in a market setting) enter into other iterated prisoner's dilemmas with different partners. To the extent that players know each other's history, reliable trading partners gravitate toward each other. Thus, part of the concatenated game's payoff to cooperators is that the reliability of their future partners is not a random variable; instead, it is a function of their own reliability. This extra payoff makes the concatenated game different from the ordinary iterated game.

Each discrete game can be viewed in isolation as an iterated prisoner's dilemma, but viewing the games in isolation is a mistake. Your defection in one game not only precludes repeat business with that partner in that game, but by affecting the reputation you bring to other games, it also limits the payoffs you can realize in those games. To the extent that reputation travels from one game to the next, the brunt of the negative externalities you create by defecting in one game will fall squarely on yourself as a player of subsequent games. If there are players who value ongoing relationships with reliable partners more than the free-rider payoff of any single game, and if these players can find each other, cooperative outcomes will emerge. And if attaining cooperative outcomes is sufficiently important, then would-be cooperators will find a way to find each other.

Thus, if the situation is a concatenated prisoner's dilemma rather than a single iterated prisoner's dilemma, reputation can operate not only within games but between them as well. In this case, the way for me to preserve my reputation for playing tit-for-tat is to cooperate even in the final period of our game, unless you defect first. Although you may free ride on me in the final period, I will be the one who acquires a reputation for being a desirable playing

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partner. I will end up being able to select other final-period cooperators as my partners, and you will have to settle for partners who reason that, since you have a reputation for defecting in the last period, they might as well defect in the second-to-last period, and so on. Reciprocity can and does carve out a place for itself in market societies, and in doing so, it can and does render those societies more cooperative.[3]

In "The Exchange and Enforcement of Property Rights," Harold Demsetz writes that the institution of private property can be thought of precisely as an attempt to exclude nonpurchasers from the use of that which others have purchased (136). Privatization of resources is the exclusion mechanism *par excellence*. Ultimately, well-enforced property rights make cooperative exchange possible, for when we see that we cannot simply take each other's possessions, and that our own possessions cannot simply be taken from us, we can attach conditions to our respective offers. For example, we can say that your corn becomes mine if and only if my apples become yours. Free-rider and assurance problems are thus eliminated, for the benefits of the productive and entrepreneurial activities involved in bringing goods to market are largely brought under the control of those who decide to undertake such activities and who bear the costs of so deciding. In this sense, the institution of private property has so effectively solved a crucial set of public-goods problems that many of us have never experienced them as problems. (In an Eastern Europe currently struggling to overcome its hostility to such institutions, however, the problems remain painfully obvious.)

One thing we should notice about this argument is that it presumes that the consummation of our exchange *can* be made to depend on our demands being met. It must be feasible for me to insist that you give me corn as a condition of me giving you apples. Enforced property rights *make it possible* to exclude nonpurchasers by providing the framework that gives agents the prerogative to act as reciprocators. For example, private property in apples allows me to hang onto my apples if I do not like the terms of your offer. But it is the reciprocity itself, not the property rights, that actually effects the exclusion. Even with private property, if we find ourselves in a one-shot prisoner's dilemma where we must choose independently whether to cooperate or defect, we are in trouble. Our corn and apples may be our private property, but that fact by

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itself is not enough. The truly crucial factor, our ability to conditionalize our offers and thus interact as reciprocators, is missing. Property rights enter the picture as one of the necessary conditions of our having this crucial ability. They give agents the prerogative to make offers on their own terms. Effectively exercising this prerogative, when conditions permit, is what actually excludes nonpurchasers. And a wide range of conditions do permit this prerogative to be effectively exercised—shopkeepers and customers typically can get what they want from each other even if they know nothing about each other's reputations and even if they expect never to see each other again.

A selection from Andrew Schotter's book, *The Economic Theory of Institutions*, concerns how social institutions emerge in response to coordination problems and prisoner's dilemmas. Schotter intends to present neither a formal theory of social institutions nor a realistic model of their emergence (149). The point is only to illustrate invisible-hand explanations. "Social institutions are human-made, and the only way to destroy them is to destroy human beings themselves. Short of that, we cannot be prevented from creating social mechanisms that make our lives more efficient" (148). The one-shot version of the prisoner's dilemma is relatively unrealistic, he says. The repeated-play model is more realistic and thus more useful as a framework within which to explain how social norms and social institutions emerge and persist.

Thus, whether government should step in to address market failure really depends on whether social norms have already filled the breach. One of the chief costs of government is that it crowds out social norms, conventions, institutions, and so on that otherwise would have emerged (or persisted) as responses to market failure. As discussed by Robert Poole (in "Fire Protection"), volunteer fire departments typically operate for about 10 percent of the cost of departments run by paid workers (308), and their rankings by insurance companies do not suggest that they are less effective in any systematic way (307). Nevertheless, once the paid workers move in, the volunteers disappear.

The paper by Carl Dahlman ("The Problem of Externality") suffers by comparison to some of the other articles in the volume, yet it also brings together many of the most important conceptual issues in the market-failure debate. Dahlman seems to think that if it would cost too much for neighbors to negotiate with a nearby

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factory to reduce its smoke output, then we have no grounds for thinking that the situation might be suboptimal. He says, "If it costs smog breathers too much to set up the exchange that induces the emittors to reduce the outpour of pollutants, then it follows necessarily that, the funny smell notwithstanding, the optimal level has been achieved" (216). Now, in ordinary language, "optimal" is a synonym for "best" and so when we describe a situation as optimal, we are ordinarily understood to be giving high praise. When Dahlman says "optimal," however, what he really means is "Pareto-optimal," which is how economists use the word. But Pareto-optimal does not mean "best"; it merely means that people would not unanimously agree that any particular alternative is better (or at least as good), which is very faint praise indeed.

Pareto criteria are widely understood to be the least offensive criteria for measuring aggregate welfare because, it is thought, they best avoid dubious comparisons of interpersonal utility. It might seem that Pareto criteria are appropriate in economic contexts, but this is often not so. In particular, it will be no comfort to the polluter's victims to say that a given pollution level is Pareto-noncomparable to the original unpolluted situation. Such an argument is particularly inappropriate when the reason for the non-comparability lies in the fact that transaction costs preclude side payments that otherwise allow a Pareto-superior move back to the original levels of pollution. In this context, Pareto criteria are irrelevant. There is an ethical question here concerning what the polluter's justification is for making others worse off. If the polluter can somehow show that the victim's suffering is for the greater good, then he has shown us something that at least utilitarians will appreciate. But if all the polluter can say is that his victims will not be able to afford to buy him off, he has said nothing of any normative consequence. The outcome may well be Pareto-optimal (in a vacuous sense) given the prevailing constraints, but that is no argument against changing the prevailing constraints. Indeed, it might be possible to change prevailing constraints in such a way as to facilitate an outcome that is Pareto-superior to what, under prevailing constraints, had previously been Pareto-optimal.

Dahlman says the concept of externalities is politically loaded. He seems to think externalities consist not merely of a gap between private and social cost, but of a gap that, by definition, government intervention can close, as indicated by such statements as "if we

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cannot assume that the government knows better, then there is no externality" (226). This is a mistake. Note that, by contraposition, Dahlman's statement logically entails that if there *is* an externality, then we *can* assume government knows better. But the fact that there is a particular gap between private and social cost says nothing about whether government will be able to close the gap. Recall that, according to Cowen's definition, an externality occurs whenever one person's actions affect the utility of another. Cowen's definition is very broad, but it is not politically loaded. It leaves open, as it should, the partly political question of when we should accept government intervention as a method of dealing with externalities.

Dahlman says with intentional irony that since markets "will not establish an optimum, it follows immediately that the government must do something since there is simply no alternative." Dahlman's skepticism is well taken since, under conditions where the market cannot attain an optimum, it would be amazing if government were able to do so. The real question (or one of them, anyway) is which can do better. That markets do not attain optima says nothing about whether government can do better. Unfortunately, when Dahlman says that if we cannot assume that government can do better, then there is no externality, he turns the argument into an inept conceptual analysis when the real thrust of the argument was a perfectly sound point about policy, namely, "given that there are certain costs of transaction and exchange, it is better to let some side effects remain" (233). No system will ever eliminate all theoretically eliminable inefficiency.

In "The Private Production of Public Goods," his second article featured in Cowen's volume, Harold Demsetz explains that, of the two defining characteristics of public goods, nonrivalry in consumption per se is no impediment to efficient pricing. Nonexcludability is what causes the problems. Demsetz notes that public goods can be produced by tie-in arrangements—arrangements whereby the price of a private and hence excludable good reflects a surcharge used to finance the production of a public good. Cowen, however, points out the vulnerability of tie-in arrangements to competition (10). Tie-ins in and of themselves are not enough. Barriers to entry are also needed, because competitors otherwise will be able to enter the market offering comparable private goods at a

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lower price by not bothering to tie in a surcharge for the public good.

The question this raises concerns the extent to which market forces themselves can supply the needed barriers to entry. Of course, someone might enter the market offering the private good by itself, ignoring the public-good component of the package deal being offered by the competition. But there may be some goods whose value is largely contingent on being provided as part of a package deal. For example, cobblers realized long ago that left shoes are more valuable when offered as parts of package deals that also include right shoes. Someone who tried to corner the market by making only left shoes and selling them at half the price of the competition's package deals would be bound to fail. Shopping-center merchants, to give an example having to do with public goods, tie the provision of malls, security forces, parking lots, and so on to the provision of private merchandise, and there are obvious reasons why entrepreneurs who try to offer the private merchandise divorced from the public goods of the shopping-mall setting have not driven the shopping malls out of existence. Likewise, developers of condominium complexes tie the provision of public services such as roads, tennis courts, and even local government of sorts to the provision of private residences. Although privately owned and privately financed, such communities become in varying degrees like small cities unto themselves, taking advantage of various public utilities as available and providing their own as necessary.

Of course, one need not be a visionary to realize that market forces can, in theory, provide shopping malls. But the point is that there is no a priori reason why similar structural ties could not lead to the provision of a variety of other public goods as well. Demsetz discusses (very briefly) a tie-in provision for national defense (142). The idea is admittedly fanciful, but whether that is because of its intrinsic impracticality or simply because modern history happens to have developed in a different direction is unclear. Government provision has crowded out market alternatives in many areas, and could have done so with shopping malls, I suppose, as it did with the predecessors of shopping malls: public-thoroughfare business districts. Perhaps this is what happened with national defense as well.

Suppose, then, that we accept Schotter's invitation to tell stories

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that, while possibly unrealistic, might nevertheless reveal something about how market forces can work, or could have worked. Let us imagine an arbitration agency at the center of a web of protection agencies, the latter being bound to the arbitration agency by mutual agreement as a means of avoiding violence among themselves. Citizens (so to speak) of the arbitration complex are bound to it by the terms of their own contracts, through the protection agencies of which they are customers. They settle disputes with clients of different protection agencies by going directly to the arbitration agency. That is also where they go to register marriages and other contracts, and so on.

Now suppose that this arbitration-protection complex is subject to external threat. Wars are very costly, of course, and so the profit motive drives these private organizations to avoid war like the plague that it is. Suppose, however, that not all of the emerging concentrations of military power are motivated by sound business principles. Or suppose that some of the emerging powers are able to reap the benefits of conquest while sloughing the costs of war onto citizens, as modern governments do. In the latter case, wars of conquest might begin to look very attractive. In these cases, the arbitration-protection complex will need to provide itself with national defense, or something like it. So the arbitration agency adds a surcharge to the fee it charges citizens for its services, and then turns the surcharge over to the protection agencies, who have the military expertise to make use of it.

This is where the vulnerability to competition noted by Cowen (10) becomes an issue, for this is the point where a would-be entrant to the arbitration market can try to undercut the incumbent by providing arbitration services without the surcharge. The would-be entrant will not succeed in this case, however, for it enters the arbitration market without affiliation to the particular network of protection agencies to which citizens have (voluntarily) bound themselves. Thus, it cannot enforce its decisions in the way that the incumbent can, and so its product cannot compare with that offered by the incumbent. The would-be entrant may be affiliated with other protection agencies, but it is not affiliated with the ones that citizens already belong to. A particular citizen might break ranks by becoming a customer of the new arbitration agency, but he will find himself without a common arbiter through which to arrange his dealings with his (former) fellow citizens. He would

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have been better off staying put. Nor will the individual protection agencies be tempted to switch allegiances, for they too depend on the established common arbiter to help arrange their dealings with fellow citizens. Moreover, the protection agencies *need* the flow of surcharges—to them it is income—that the incumbent arbiter gives them in order to protect themselves and their clients from the external threat. Avoiding the surcharge is the last thing they want to do. (Would-be entrants into the protection market have access to this extra income only if they are permitted to join the complex on behalf of which the arbitration agency is collecting the surcharge, and they will be permitted to join the complex only if they do their part in defending it.) Therefore, the arbitration agency is safe from challenge unless it is so much less efficient than its would-be replacement that citizens and protection agencies switch over *en masse*.

Perhaps the imaginary arbitration-protection complex is unstable (or even impossible), but the point of the exercise is to show that it is not any particular vulnerability of its tie-in arrangement to market forces that renders it unstable (or impossible). The existence of shopping centers verifies that market forces can drive the tie-in provision of public goods, and this fanciful story is meant to show that the same market forces might, under the right conditions, drive the tie-in provision of other public goods as well.

Many of the papers in Cowen's collection challenge the conclusion that widespread market failure justifies government activity by challenging the premise that widespread market failure really occurs. This is an important challenge. Indeed, insofar as the legitimacy of a particular government activity depends on whether government activity does more good than harm, the challenge is crucial.

NOTES

1. See R. Mark Isaac, David Schmidtz, and James M. Walker, "The Assurance Problem in a Laboratory Market," *Public Choice* 62 (1989): 217–36.
2. This idea comes from David Kreps, Paul Milgrom, John Roberts, and Robert Wilson, "Rational Cooperation in a Finitely Repeated Prisoner's Dilemma," *Journal of Economic Theory* 27 (1982): 245–52.
3. See also David Schmidtz, *The Limits of Government: An Essay on the Public Goods Argument* (Boulder: Westview, 1991), 99–102.

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Hal R. Varian

MARKETS FOR PUBLIC GOODS?

There is a presumption in some circles that the identification of an externality or a public good presents a prima facie case for government intervention. Tyler Cowen has assembled a group of articles that challenge this view by arguing that the market, broadly construed, can handle many problems of public goods and externalities that are normally considered the province of the state. Although these articles present a stimulating perspective on problems of externalities and public goods, several of the essays overstate their case and misrepresent the standard theory of public goods and externalities.

Economic theory argues that under certain conditions free markets may be expected to provide a Pareto efficient allocation of resources. Among these conditions is that there are no *externalities.* Roughly speaking, this requires that consumers and firms only care about their own choices, not about the choices of other economic agents.

In reality there are many sorts of externalities. I may care about how loudly my neighbor plays his stereo or the color that he paints his house. More importantly, I may care about how he may vote since that will determine in part the level of production of various publicly provided goods like schools, roads, and streetlights.

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Since there are many externalities of this sort in real life it follows that we cannot expect that market outcomes will be perfectly efficient. But this is a very weak statement: most of the other assumptions necessary to ensure efficiency are also violated to one degree or another. The question is not whether the market mechanism is *perfectly* efficient, but rather whether it is reasonably efficient when compared with alternative mechanisms.

When someone says that there is a "market failure," an appropriate reply is "relative to what?" It may well be that the market mechanism will be inefficient in the presence of externalities, but other forms of resource allocation—such as political intervention—may be even more inefficient. To paraphrase George Stigler, saying that market failure is a justification for governmental intervention is like awarding the grand prize to the first entrant in a contest before even looking at the other entrants.

Public goods are a well-known kind of externality. According to the textbook definition a "pure" public good is *nonrival,* meaning that one person's consumption of it does not reduce another person's, and *nonexcludable,* meaning that individuals cannot be prevented from consuming the good. Generally there is some particular amount of a public good supplied, and everybody must make do with the available amount. The classic example of a pure public good is national defense. Other commonly used examples are TV and radio broadcasts, streetlights, roads, lighthouses, and so on.

Ordinary goods are both excludable and rival: I have the right to prevent you from consuming my candy bar and if I take a bite from it, then there is less candy available for you to consume. Some goods (e.g., a private swimming pool) are excludable but partly rival. The pool is excludable since unauthorized users can be prevented from using it. It is partly rival since the presence of other users may affect my enjoyment of the pool. If a good is partly rival in this way it is sometimes called *congestible.*

Many "pure" public goods turn out to be "impure" upon closer inspection. My use of streetlights *can* be affected by your use—if I happen to stand in your shadow. Similarly, my use of the roads may well be affected by how many other people are using them. The issue is one of degree. Roads are congestible so they aren't a *pure* public good—but there's still a big difference between a road and a candy bar.

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Public Goods and Market Failure

Conventional economic theory claims that the amount of a public good will generally be undersupplied in a free market. More precisely, if each agent makes an *independent* decision about how much he or she will contribute to a public good, the resulting allocation will be Pareto inefficient. That is, there will be some other allocation of resources that will make *all* agents better off.[1]

Conventional theory does *not* claim that public goods will not be privately supplied *at all,* just that an efficient amount will not be supplied by purely voluntary actions. My neighbor grows flowers for his own satisfaction: the fact that I enjoy seeing his flowers makes them a public good. This doesn't prevent him from growing his flowers; however, it is certainly possible that if I were to contribute to his horticultural efforts he might grow more flowers, which would make us both better off.

An Example of the Problem of Public Goods

Let us consider a more detailed example to fix some of these ideas. Suppose that Andy and Bob contemplate putting up a streetlight in front of their houses. One streetlight costing $600 will be adequate to provide lighting for both houses. Each person values the services of the light at $400. If each person makes an *independent* decision about whether to provide the light, the light will not be provided, since the benefit to each person ($400) is less than the cost of the light ($600).

However, if Andy and Bob get together they can each agree to contribute $300 to the streetlight. Each of them would then be better off since they each would be getting something worth $400 to each of them at a cost of only $300 per person. Providing the streetlight and splitting the cost in this manner is a Pareto improvement over the case where each person makes an entirely independent decision.

Another efficient allocation would be for Andy to pay $350 and Bob to pay $250. This would still be adequate to cover the cost of the streetlight and leave Andy and Bob with positive net benefits. In general any division of payments that leaves each consumer with positive surplus and sums up to $600 will be a Pareto-efficient

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allocation that makes both people better off than they would be without the streetlight.

Suppose now that Andy values the streetlight at $700 and Bob values it at $200. If they each act independently Andy will purchase the light for $600 and Bob will *free ride* on this choice. The allocation resulting from this kind of independent decision is still Pareto efficient, since there is no way to make one of the parties better off without making the other party worse off.

What if negotiation is allowed? We can imagine all sorts of things that might happen: Andy may well argue that Bob should pay "his fair share" of the streetlight. But Bob may easily decide to hold out since he knows that Andy will be willing to provide the streetlight on his own. We can observe that it is Pareto efficient to provide the streetlight, but we can't say anything much about how the costs will be covered without knowing more about the strategic choices open to Andy and Bob.

When examined in such a simple model it seems that problems with public goods can't really be too serious. After all, people can just get together and solve them, right? This is probably true for the kinds of simple two-person, yes-no problem just considered.[2] But what happens when the problem gets more complicated?

Suppose that the placement of the streetlight is variable. Bob wants it closer to his house, and Andy wants it closer to his. Bob argues that he has a bigger house, so he needs better illumination. Andy finds this argument unconvincing. Now the simple yes-no problem becomes more complex: where should the light be located and how much should each party pay? Andy and Bob may well devote considerable time and effort to negotiating the outcome.

A particularly problematic case is when Andy and Bob don't know how much the other person values the streetlight. Each may hold overly optimistic beliefs that the other will provide the streetlight if he just holds out. In this case it seems that there is a clear inefficiency: if they could just get together and lay their cards on the table they could readily accomplish their (joint) objective. But opportunistic behavior may leave them both worse off.

What if we consider streetlights for a whole neighborhood or a whole city? The problem quickly becomes very complex. Even though everyone may agree that it is better to have streetlights than not have them, the costs of negotiating where the streetlights will be placed and how they will be paid for may be quite high.

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Contrast this to the problem of how much ice cream should be produced and consumed. Here the market provides a simple, decentralized solution: each consumer looks at the price of ice cream and the amount of money she has and decides how much ice cream she wants to purchase. She doesn't have to worry about how much anybody else wants to consume.

Even in the case of a pure private good, such as ice cream, it is important to recognize that other people's consumption *really is* relevant to me. If everybody else eats all the ice cream, none will be left for me. But this information about how much other people value ice cream is all summarized in the market price, which I take into account when making my own choices.

Determining how much ice cream there should be is, in principle, just as difficult as determining how many streetlights there should be. But since individuals only care about their own consumption of ice cream, and not other people's consumption, the overall allocation problem can be separated into lots of little allocation problems that can be solved by each individual consumer. All the information necessary for resource allocation is summarized in one number—a price. This sort of decentralized solution is not available for the public-goods problem. Public goods, it is claimed, lead inevitably to *market failures*, and subsequent calls for governmental intervention.

Private Provision of Public Goods, and Vice Versa

But perhaps we are giving up on private markets too soon. Is it possible to find some way to decentralize the allocation of public goods in the same way the market decentralizes the allocation of private goods?

Indeed, we often use a variety of "decentralized" ways to determine the amount of a public good. Simple negotiation is often effective. There are legal remedies available when one party imposes costs on another. Voting and other forms of government can be used to determine how much of a public good is provided and how it should be paid for.

But these mechanisms have costs. Negotiation is a costly activity, especially when parties have little information about the payoffs to other parties. The legal system involves heavy transactions

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costs. Voting will only produce efficient outcomes in certain situations.

The branch of economic theory called mechanism design attempts to devise various ways to solve economic allocation problems. Similarly, the new institutional economics tries to explain how real-world institutions serve to solve various kinds of resource allocation problems that lie outside the scope of the traditional economic institutions such as markets.

Mechanism-design theorists have come up with a number of clever ways to "solve" externality and public-goods problems. But this literature is primarily theoretical in nature, and there are few examples of actual applications. Most of the applications that have been tried in the laboratory, or in small-scale experiments, have been fairly straightforward variations on markets.[3]

Most of the commonly used examples of public goods are goods that are provided by governments. But there are many other examples of nongovernmentally provided public goods. A mother and a father each cares about their child's welfare so the child's welfare is a public good for them. Similarly, the cleanliness of the kitchen is a public good for the inhabitants of the household. Family life is filled with externalities and public goods.

Even goods that are normally supplied by government may also be supplied privately. Television broadcasts are supplied by government in some countries and privately in others. Roads, bridges, fire protection, and so on are commonly provided by government but have often been provided privately.

On the flip side, goods that are inherently private goods are often supplied by governments. Education is a notable example. It is excludable and diminishable—private schools are perfectly feasible and widely available. Yet most governments have taken it upon themselves to provide public education.

The essays in *Public Goods and Market Failures,* edited by Tyler Cowen (New Brunswick, N.J.: Transaction, 1992), are concerned with many of these issues. The central theme of these essays is that the "private" provision of public goods may not be as bad (or as inefficient) as economists have thought. If there are "market failures," various institutions may arise to solve these problems. Even if this doesn't happen automatically, there are a variety of ways that the government might encourage the provision of public goods in

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a more flexible and efficient manner than direct governmental action.

Samuelson and Bator: Straw Economists

The collection begins with two classic articles that describe the problem of market failure: Samuelson's "The Pure Theory of Public Expenditure" and Bator's "The Anatomy of Market Failure." These articles are presumably included since they lay out the premise that the rest of the articles attack: if there is a market failure, then the state should provide the remedy.

It is worth observing that neither Samuelson or Bator actually say this. Samuelson simply points out the problem that the classic market mechanism won't work well when public goods are present, and that some other sorts of mechanism are likely to be desirable. He mentions "voting" and "signalling" as possibilities but doesn't attempt to explore alternatives to the private market. Bator is even more explicit. He says: "As long as activities have even a trace of publicness, price calculations are inefficient" (64). But he quickly adds in a footnote: "This is not to say that there exist other feasible modes of social calculation and organization that are more efficient" (64).

In other writings Samuelson is careful to indicate that the mere identification of a public good is not necessarily a call for government intervention:

> The pure theory of public expenditure . . . often uses the term "public good" but cannot properly be interpreted to imply that that private goods should be produced by private enterprise and public goods should be produced by government directly. . . . Where the consumption externalities intrinsic to a non-private good occur, all that I would insist on is that *laissez faire* can not be counted on to lead to an optimum. There is a *prima facie* case, so to speak, for social concern and scrutiny of the outcome; but that does not necessarily imply outright state ownership in every case public regulation. The exact form in which the social concern ought to manifest itself depends on a host of considerations that have to be added to the model.[4]

It is hard to find a respectable economist who has maintained that market failure *requires* "government management." So it must be acknowledged at the outset that to some extent the essays in Cowen's book are attacking a straw man. Despite this qualification,

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it is safe to say that there is a liberal orthodoxy that leans in the direction of government intervention as the "solution" to externalities problems. The essays in this volume provide a counterweight to this orthodoxy by examining alternatives to the blunt instrument of government intervention.

To this extent they are successful: the essays remind us that there are a number of nongovernmental institutions that can be used to provide public goods, even public goods that are conventionally supplied by the government. But this point is clear to anyone who has thought seriously about public goods. The standard theory of public goods doesn't call for government intervention—it just says that when public goods are present, simple markets won't achieve efficient outcomes. Conventional economic theory is mute on the question of whether there is any other mechanism that will improve upon the market. Indeed, the standard theory is perfectly open to the view that some sort of hybrid mechanism may do better than direct government intervention. The conventional theory of public goods, when properly understood, is perfectly consistent with many of the views expressed in the essays in Cowen's book.

Shedding Some Light on Lighthouses

Coase's famous essay on "The Lighthouse in Economics" can serve as a case in point. Coase begins his essay by examining some claims made by Mill, Sedgwick, Pigou, and Samuelson on the lighthouse. Each of these authors points to the difficulty of charging ships for their use of the lighthouse services; this is the problem of nonexcludability that is *one* of the defining features of a public good. According to Coase, only Samuelson refers to the nonrival aspect of the lighthouse as a public good. Even if the owners of the lighthouse were *able* to charge for its services, it would be inefficient to allow them to do so since it costs the owners nothing to service additional ships.

Coase criticizes Samuelson's observation by saying: "There is an element of paradox in Samuelson's position. The government has to provide lighthouses because private firms could not charge for their service. But if it were possible for private firms to make such a charge they should not be allowed to do so (which also presumably

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calls for government action)" (257). But there is no paradox in Samuelson's position—Coase presumes too much. Samuelson's point is that problems of nonexcludability may lead to an inefficient underprovision of lighthouses—the usual problem with public goods. But even if the excludability problem were solved, charging a positive price would lead to another sort of inefficiency since the price of the service would exceed its *marginal* cost of provision. *Efficient* provision of lighthouse services requires a zero *marginal* price since there is a zero marginal cost to servicing additional ships. We return to this point below when we examine the pricing system used by lighthouses in Britain.

The main purpose of Coase's essay is to examine the history of the British lighthouse system: "a study of the history of the British lighthouse system is [useful] because it serves to enlarge our vision of the range of alternative institutional arrangements available for operating a lighthouse" (261). We will briefly review this history here.

The "official" provider of lighthouses in the seventeenth century in Britain was Trinity House, a charitable organization that evolved from a medieval seamen's guild. Trinity House apparently did not satisfy the demand for lighthouses, and private profit-seeking individuals actually provided the majority of the lighthouses built in the seventeenth century.

> The method used by private individuals to avoid infringing Trinity House's statutory authority was to obtain a patent from the Crown which empowered them to build a lighthouse and to levy tolls on ships presumed to have benefited from it. The way this was done was to present a petition from shipowners and shippers in which they said that they would greatly benefit from the lighthouse and were willing to pay the toll. The tolls were collected at the ports by agents . . . who might be private individuals but were commonly customs officials. The toll varied with the lighthouse and ships paid a toll, varying with the size of the vessel for each lighthouse passed. . . . Books were published setting out the lighthouses passed on different voyages and the charges that would be made. (263)

Faced with this competition from the private sector, Trinity House began to apply for patents to operate lighthouses and then sold these rights to individuals who would build and operate lighthouses. Many lighthouses were built in this manner, but eventually dissatisfaction arose. A report from the House of Commons argued that it would be better to consolidate all lighthouses under a single

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operating authority, Trinity House. The report indicates several reasons for this conclusion: differences in operating and billing procedures; inadequate and slow provision of lighthouses "often after disastrous losses at sea" (268); and "heavily taxing the Trade of the country, for the benefit of a few private individuals" (268). Coase asserts that the last of these problems was the most important one, although he presents no evidence for this claim.

In order to consolidate the operation of lighthouses, Trinity House purchased the lighthouses from their owners using mortgages backed by the lighthouse dues. Once the loans were paid off, the government requested that Trinity House reduce the lighthouse tolls. Trinity House objected venomously to this proposal, but was overruled in court. In 1898 the system was again reformed: the dues were simplified and paid into a General Lighthouse Fund, "which was to be used solely for the maintenance of the lighthouse service" (272).

What does Coase conclude from this history? He seems to think that it shows that the conventional theory of public goods does not provide an adequate description of lighthouse provision in Britain. He makes several points.

First, "contrary to the belief of many economists, a lighthouse service can be provided by private enterprise" (276). But what economist has claimed that public goods cannot be privately provided? None, as far as I know. The only claim is that public goods will be provided at a less-than-efficient level. The House of Commons report quoted by Coase seems to concur with this point—it explicitly asserted that there was an inadequate supply of lighthouses in Britain.

Coase also argues that charging ships for lighthouse dues was not inefficient, since the toll structure was highly nonlinear: after the first 10 voyages the marginal toll was zero. He writes: "It is difficult for me to resist the conclusion that the benefit which would come from the abandonment of the light dues would be very unimportant and that there would be some loss from the change in the administrative structure" (275). But this is completely consistent with standard economic theory: efficiency implies that since the marginal cost of providing an additional ship with lighthouse services is zero, the *marginal price* paid by each ship should be zero. This is exactly the point made by Samuelson with which Coase took issue.

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Coase further claims that he has shown that "the charges were collected at the ports by the agents for the lighthouses. The problem of enforcement was no different for them than for other suppliers of goods and services to the shipowner. The property rights were unusual only in that they stipulated the price that could be charged" (276). But this seems to me to be entirely wrong. When I buy a loaf of bread I am charged for that loaf of bread. When someone used the services of a lighthouse in Britain he was charged only if he *also used a port in Britain.* If everyone who used lighthouse services in Britain also used a port in Britain, and people could be excluded from port usage, then the fact that they could not be excluded from lighthouse usage was of little consequence: fees for lighthouse usage could be built into the port fees, as indeed they were. In the jargon of economists, the authorities were able to *bundle* a private good—landing rights at a port—with a public good—the services of the lighthouse, thereby avoiding the nonexclusion problem.

Finally, Coase claims that making the immediate beneficiaries (the shippers) pay tolls for the service made the provision of lighthouses more efficient: "It would seem a safe conclusion that the move to support lighthouse service out of general taxation would result in a less appropriate administrative structure" (275). This, it seems to me, is a fair point. Samuelson's theory would argue that it is efficient to have lighthouses provided by lump-sum taxation—an extreme form of the nonlinear pricing that was actually used. But Samuelson is mute on the point of *who* should be taxed—his theory does not have a model of bureaucratic behavior, and thus cannot compare the relative efficiency of various administrative structures.

Coase concludes his essay by asking, "How is it that these great men have . . . been led to make statements whose meaning, if thought about in a concrete fashion, is quite unclear, and which, to the extent that they imply a policy conclusion, are very likely wrong?" (275). Coase implies that economists have gone so far off track because they failed to undertake a detailed study of lighthouses, such as Coase's study. But Coase's critique of "these great men" is simply wrong: the conventional theory of public goods, as espoused by Samuelson and others, *does* provide essential insights into the functioning of the British lighthouse industry—insights that Coase did not apparently recognize.

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When one examines Coase's essay in more detail, one sees that there are several places where state intervention was practiced: Initially, the state granted exclusive rights to Trinity House to construct lighthouses. When Trinity House failed to provide lighthouses in adequate numbers, the state granted the right to others to construct lighthouses and collect fees. The state cooperated in collecting these fees. Finally, due to flaws in the private provision of lighthouses, the state granted Trinity House authority to acquire the existing lighthouses and operate them under uniform procedures.

From the viewpoint of economic theory there are several interesting features of Coase's story. First, there is the question of how the demand for lighthouses was determined: a private individual collected a petition with signatures of shipowners agreeing to pay a fee for a lighthouse.

It is known that efficient provision of a public good *is* an equilibrium for this mechanism. We can see this easily using the streetlight example described above. Recall that Andy and Bob are each willing to pay $400 for a streetlight, but that it costs $600 to provide one. Suppose that a streetlight contractor offers them each the following deal: they each write down a price, and if the sum of the prices exceeds $600, the contractor will build the streetlight.

It is easy to see that each of them writing down $300 is an equilibrium: if I think that the other person will write down $300, then my best response is to write down $300. This shows that at least one equilibrium of the game results in efficient provision of the public good.

However, this is not the only equilibrium. Andy writing down $350 and Bob writing down $250 is also an equilibrium. More troubling is the fact that each writing down $0 is an equilibrium: if the other person writes down $0, then I may as well write down $0, since there is no loss to be from doing so. So there are *inefficient* equilibria to this game as well as efficient ones.

Still, it appears that this sort of game worked reasonably well in assessing the demand for lighthouses. The pure game-theoretic analysis leaves out effects (such as repeated interaction) that were likely important in practice.

A second point of interest is the method of collecting the payment: through port fees. The rationale for this is that the services of the public good can only be consumed in conjunction with the

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(easily monitored) consumption of an excludable good—use of a complementary good, namely, the services of the port. This is just like making TV broadcasts excludable by coding the broadcast and charging a rental fee for the decoder.

Note that state intervention is required to support this mechanism: the state must restrict competition. If the Port of Brunswick is required to collect fees to cover lighthouse services, what happens if the Port of New Brunswick opens up down the road and does not charge lighthouse fees? Or to use a more modern example, what happens if your neighborhood electronics store starts selling decoder boxes?

Selling an excludable complementary good only works if the state grants a monopoly on the provision of the complementary good. In a perfectly competitive environment, providers wouldn't be able to sell the complementary good for more than its cost of production. But granting a state monopoly has efficiency costs as well: it is by no means apparent that this solution to the public-goods problem will always be an optimal one.

Is There Any Such Thing as a Pure Public Good?

Kenneth Goldin's contribution to the volume argues that there's no such thing as a public good: "The evidence suggests that we are *not* graced with a set of goods and services which have inherent characteristics of public goods. Rather we are faced with an unavoidable choice regarding every good and service: shall everyone have *equal access* to that service (in which case that service will be similar to a public good) or shall the service be available *selectively* to some, but not to other?" (69). Goldin supports his claim by examining several traditional examples of public goods. He argues that government services such as defense, police, roads, and lighthouses are in fact rival at least to some degree since one person's enjoyment of them depends on how many others are consuming them. To me these arguments are splitting hairs: pure public goods are admittedly an extreme case, but then again so are pure private goods. To say that all goods are partly rival may be true, but it doesn't really say very much.

In a like vein, Earl Brubaker advances the claim that "free riding" is a myth: this kind of strategic behavior "has little empirical scien-

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tific basis, and that, in fact, recently available experimental evidence seems much more nearly consistent with some plausible alternatives" (93). Brubaker's article was first published in 1975, and at that time this statement was a reasonable one. However, there have been almost 20 years of experimental economics investigation of the free-rider problem since then.[5] The picture painted by recent evidence is rather complex, but I think that the following summary is fair: small groups of experimental subjects do not free ride as much as the pure theory would predict; however, there is still significant free riding in such groups. Furthermore, the more experience that such groups have with public-goods games, the more free riding is observed.

Rather than denying the reality of the public-goods problem, Harold Demsetz claims that "given the ability to exclude nonpurchasers, private producers can produce public goods efficiently" (111). Demsetz says that "there is nothing in the public good concept that disallows the ability to exclude" (113). This is certainly not true for today's conception of a public good, and I would venture that nonexclusion was considered to be an inherent part of a public good even when Demsetz's article was written. But let us give him this point and contemplate resource allocation with an excludable public good.

Demsetz considers two market forms. In one, TV tapes are sold to customers who view them in their own homes; in the other, the same TV shows are broadcast to everyone. Demsetz argues that as long as you can exclude customers from viewing broadcast television show, the two markets are essentially equivalent. I agree with this claim. However, it certainly does not follow that *either* market is efficient. In fact, I would argue that an unregulated tape market would exhibit the same inefficiency that an unregulated TV broadcast market would exhibit.

Suppose that once a TV program is produced, the cost of copying a tape is negligible. This implies that additional viewers of the tape can be accommodated at negligible marginal cost, just as additional viewers of the broadcast can be accommodated at negligible marginal cost. But if competition forces the price of a tape down to marginal cost, how can the producer generate the revenue to cover the costs of producing the TV show in the first place? This is the same question that arises with public goods: if the public good is priced at the marginal cost of production of an additional viewer,

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revenues won't cover the total costs—which means that marginal-cost pricing is unfeasible.

One solution to this problem is for the state to create property rights in intellectual property and punish those who make illegal copies. This creation of monopoly rights makes the market in videotapes *viable,* but there is no reason to think that it is efficient. The problem is the standard problem with a natural monopoly: marginal-cost pricing is unfeasible since it won't cover costs, and monopoly pricing is inefficient for the usual reasons.

Local Public Goods

Charles Tiebout's famous paper examines public goods that have a limited set of users. Public parks are a public good of sorts, but their services are provided only to a restricted clientele: those who live close enough to them to take advantage of them. This group of people overlaps to a great extent with the people who pay for the public parks, namely, the taxpayers in a given community. There are many other public goods of this sort: streets, streetcleaning, streetlights, and so on.

Tiebout's insight was to recognize that cities and towns compete with each other in providing public goods. By supplying more and better local public goods, towns attract taxpayers. Although all taxpayers in a given location have to consume a particular level of public parks, taxpayers can choose the level of public parks they want by choosing where they want to live.

If there are enough diverse communities that supply different amounts of parks, each person can choose the community that is right for him. The public-goods problem has disappeared, since each individual is purchasing the package of public goods that is optimal for him by choosing where he wants to live. One can argue with Tiebout's point on technical grounds, but there is certainly merit in the basic idea.[6]

The idea of equal educational opportunities is widely accepted these days—so much that people tend to forget the other side of the issue. Allowing for differences in educational expenditures—or other aspects of local education—allows people to choose different amounts and kinds of education for their children by choosing where they live. If the state succeeds in equalizing educational ex-

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penditures across all districts, taxpayers will be more reluctant to to spend on education at all, preferring to vote to reduce public expenditure on education and to send their own children to private schools. Breaking the link between local taxation and local provision of public services is a dangerous game to play.

Similarly, courts have recently found that the city of Dearborn, Michigan, was in violation of civil rights laws by excluding nonresidents from using their parks. But if courts dilute the property rights of municipalities that supply local public goods, the taxpayers in those municipalities will no longer be willing to supply such goods. Is this really in the social interest?

Getting Stung by Externalities

The economist J. E. Meade used the example of an apple grower located next to a beekeeper as a parable for his discussion of externalities. Meade argued that if the apple grower and beekeeper made unilateral decisions about the operation of their facilities the resulting allocation of resources would be inefficient. "We call this a case of an unpaid factor, because the situation is due simply and solely to the fact that the apple farmer cannot charge the beekeeper for the bees' food."[7]

Steven Cheung's article investigates the actual contractual arrangements governing the interactions of beekeepers and apple growers in Washington State circa 1972.[8] He found that there was a well-developed market for bee pollination services. Beekeepers would bring hives to orchards during blossom season and collect a fee from the apple growers for the pollination services provided by the bees. Cheung identifies a few problem externalities with these arrangements: bees may also fertilize neighbors' orchards, and a farmer who uses pesticides while a neighbor is trying to pollinate his crop may incur the wrath of both the apple grower and the beekeeper. However, Cheung says that these issues do not pose serious problems because of the repeated interactions of apple growers with their beekeeping neighbors.

Cheung doesn't mention the possibility of internalizing the beekeeping externality. I grew up on an apple orchard in Ohio and the common practice there was to keep your own hive of bees. I recall that we hired a professional beekeeper now and then to re-

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move the honey, control swarming, and so on, but the bees were owned by my family.

Here we have three kinds of property rights for bees and orchards: totally independent (as described by Meade), independent ownership with contractual relations (as described by Cheung), and internalized (as practiced on the Varian orchard). Meade's case is probably seldom practiced since it would, as he argued, certainly be inefficient. Although he suggests that some kind of "subsidies and taxes" must be imposed, it is clear that the more common solution is private contracts or internalization. Meade is right that independent operation is inefficient: he was wrong to leap immediately to a tax/subsidy solution. The private market seems to do a pretty good job in providing bee services, either via internalization or subcontracting.

Contracting for the Production of Public Goods

Robert Poole, Jr., claims in his chapter that "most people think of fire protection as a typical public good" (305). I don't know if most people think that or not, but certainly most economists shouldn't think of fire protection as a public good. Is it excludable? Yes. Is it congestible? Yes, but only to a slight degree. The "public" aspect of fire prevention is rather different than that suggested by Poole. The problem is that inadequate fire prevention at my neighbor's house, for example, can increase the risk of fire to my own house. If my neighbor doesn't subscribe to a fire protection "club," it can be costly to me.

Poole's claim that "fee for use" and "private provision of 'public' services" are likely to be more efficient than government provision is likely true, but beside the point. Even if a local governmental unit decides to use, say, private garbage pickup, it still typically requires all residents to contract with a garbage pickup service. Presumably this is due to the negative externalities of letting garbage pile up in one's backyard and the economies of scale of using a single garbage service.

Poole is right that it is often more efficient for governments to contract with private firms to provide services, and they have often done so. States have also provided public defense by hiring mercenaries, and have even auctioned off the right to collect taxes to

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private individuals. But this seems to me to be a side issue to the fundamental questions about public goods. The public-goods question is concerned with *what* and *how much* the state should provide of various services; Poole's essays are concerned with *how* these services should be provided. Samuelson would find little to take issue with in Poole's essays, as would most economists who are knowledgeable about public goods.

* * *

The common theme of these essays is that they challenge the "market failure conclusion that many economists and policymakers have drawn from Samuelson's theory" (1). This is a fair statement, but it is important to point out that a *correct* understanding of the theory of public goods does not lead to the claim that they must be publicly supplied. Certainly Samuelson made this point quite clearly.

Nevertheless, it is fair to say that this point has not been sufficiently appreciated, and this collection of essays is an important antidote to claims of market failure. The message that I take away from these essays is not that the state should *refrain* from intervention in problems involving public goods, but rather that the state should be more open to a richer set of institutions that facilitate private solutions to public-goods problems.

The solutions to public goods offered by the essays in this volume take a variety of forms: tying arrangements, private contracts, repeated interactions, exclusion, subcontracting, and so on. But as we have seen these solutions often require some form of public intervention. For example, tying arrangements can only succeed when competition can be prevented; exclusionary provisions and contracts must be sanctioned by the state; and so on. It is not government intervention itself that is the problem, but rather the form of the intervention. Tyler Cowen has done us a great service by pulling together a set of essays that remind us of this fact.

NOTES

1. For the economic theory of public goods, see R. Cornes and T. Sandler, *The Theory of Externalities, Public Goods, and Club Goods* (Cambridge: Cambridge University Press, 1986).

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2. But perhaps the divorce rate statistics show that even two-person externality problems aren't so simple.
3. See John Ledyard, "Public Goods: A Survey of Experimental Research," *Handbook of Experimental Economics* (Amsterdam: North-Holland, forthcoming).
4. Paul Samuelson, "Indeterminacy of Government Role in Public-Good Theory," in R. C. Merton, ed., *The Collected Scientific Papers of Paul A. Samuelson*, vol. 3 (Cambridge, Mass.: MIT Press, 1972), 52.
5. Ledyard, n3 above.
6. See Truman Bewley, "A Critique of Tiebout's Theory of Local Public Expenditure," *Econometrica* 49 (1981): 713–40. The assumption that there are "enough diverse communities" alluded to above is an important caveat.
7. J. E. Meade, "External Economies and Diseconomies in Competitive Situation," *Economic Journal* 54 (1952): 56–65.
8. For a more current popular exposition of the economics of beekeeping, see A. Marison, "America's Beekeepers: Hives for Hire," *National Geographic* 183, no. 5: 73–93.

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Harold Demsetz

THE PRIVATE PRODUCTION OF PUBLIC GOODS, ONCE AGAIN

Anthony de Jasay attempts to demonstrate that public goods can be supplied privately without loss of efficiency, since there may be enough people willing to finance public-goods production voluntarily, even at the risk of subsidizing free riders, rather than risk that public goods will not be produced at all. Jasay's argument rests on the implausible assumption that the goods in question are completely indivisible. This assumption forces persons interested in having a given public good either to finance it or do without it entirely; they do not have the option of financing smaller quantities or poorer qualities of the good.

"The point of this book is to demonstrate that there is no public goods dilemma in Hobbes's fatal sense . . . for voluntary contribution to shared benefits can be fully consistent with the successful pursuit of narrow self-interest. Willing surrender of free choice in the matter, as social contract theory would have us do, cannot be accounted for by our desire to attain purportedly better states of affairs than our uncoerced self-seeking could bring about" (4).

This claim, early in Anthony de Jasay's *Social Contract, Free Ride* (New York: Oxford University Press, 1990), is open to interpretation. The boldest reading is that the demonstration to follow will

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show the theory of public goods to be a logical fallacy, at least insofar as it provides a rationale for public provision of goods. Alas, this turns out not to be the case. Instead, Jasay substantiates a lesser, but not unimportant, claim—that the rationale for government provision of goods by appeal to the theory of public goods is much weaker than is commonly supposed—if the good can be produced only in fixed quantity and quality.

The intellectual history of the theory of public goods highlights two facets of the problem. The first is associated with the initial development of the theory by Paul Samuelson and others, who discussed the possibility that some people's consumption of certain goods does not reduce the supply available to other people. Additional drivers can use a bridge without precluding others' use of it if there is no congestion on the bridge.

On these grounds, the early theorists argued that if the goods are produced at all, efficiency is served by not denying them to potential users. Efficiency seems to call for no price barriers to their consumption. To charge each driver for crossing a bridge would overly restrict crossings, as long as the bridge remains uncongested. The price per crossing should, then, be zero. Yet there is a cost to building the bridge. Since this cost should not be recovered by positive prices per crossing, it will need to be covered from the public treasury. Hence, an argument for government financing of "free" public goods.

The weaknesses in this rationalization are by now well known. Hasn't the bridge been built too large if there is no congestion? How are the correct number of bridges, and their locations, to be determined if there is no (price) gauge of their value to drivers?[1] How do we know the state is motivated to seek economically efficient solutions to these problems?

A second argument for public provision, introduced somewhat later, is that it may be so costly to exclude users of a good once the good becomes available, even if it could not be used simultaneously by more than one person, that there would be little incentive to produce it privately. Here the issue is not the desirability of excluding by price but the *impracticality* of doing so. Price is an ineffective rationer if everyone can use a good without paying for it. This problem is more general than the public-good problem, as it can apply both to public goods and to private goods. No two people can drive the same car at the same time, so an automobile is not a public good in Samuelson's sense. It is a private good. Yet, if it were trivi-

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ally simple to steal a car, and if there were no effective penalty for theft, it might be in no one's interest to purchase a car from his own funds. A situation could be faced in which the total value to be derived from the use of automobiles exceeds their cost, yet it would not be profitable for anyone to produce cars privately. Either the inability to exclude or the desirability of not excluding (the public-good case) can be used to justify the state's production of goods, although the justifications differ.[2]

Not many production functions make it impossible to exclude nonpayers if enough resources are devoted to the task. As Jasay notes in an interesting discussion of this aspect of the problem, even the traditional example of the lighthouse, whose beam would seem freely available to all who sail within its range, can be provided on an exclusive basis to those who pay if enough is invested in electronic scramblers of one sort or another.

Jasay does not, however, wish to rely on the possibilities of resolving these problems through exclusionary devices. That some persons may be excluded from the consumption of that which others purchase is less important to Jasay than that they are not in fact excluded. That is, attendance at public schools could be, but is not in fact, limited only to those who pay. I am not sure I would wish to downplay the role of exclusion, as Jasay chooses to do, for the solution to the problem of supplying such goods may turn quite simply on introducing a practicable barrier to consumption unless payments are made. Yet, one must compare the cost of exclusion to its benefit, and such comparision may make it seem unwise to practice exclusion. In any case, Jasay takes as his task the exploration of resolutions of these problems that do not rest on the use of either the state or private exclusionary devices.

The nonexclusionary private provision of such goods requires them to be financed by those who want them intensely enough to pay for them voluntarily, and to do so even when this means subsidizing "free riders," and even though they themselves could try to be free riders. The main burden of Jasay's book is to convince the reader that efficient levels of production will obtain under these daunting conditions.

Jasay insists on holding to two assumptions about private behavior while attempting the demonstration: (1) each participant's choice is motivated solely by self-interested maximization; and (2) persons attempting to resolve the coordination problem are not knowingly engaged in repeated encounters with each other. The first of these

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bars resolution of the problem by means of altruistic behavior, while the second excludes the possibility that repeated encounters between people would lead to a tit-for-tat strategy for securing voluntary contributions.

Jasay conceptualizes the problem as a prisoner's dilemma. Each potential financer of production faces a probability that the good will not be produced at all if he does not contribute to its financing, and a probability that he will be able to free ride on someone else's financing if he refuses to contribute. A potential user of the good is best off in this latter case if in fact others finance the good, but he is better off contributing to the financing of the good if there is a serious threat that failure to contribute will jeopardize its production.

In the traditional prisoner's dilemma, where each of two prisoners must choose either to confess and implicate the other or to remain silent in the hope that the other prisoner will also remain silent, the expected payoffs assigned to alternative strategies dictate confession. By appropriately adjusting the expected payoffs associated with each combination of strategies, however, it is possible to produce a situation that requires each prisoner to remain silent. Jasay applies such adjustments to the strategies of voluntarily contributing to the production of a public good or refraining from contributing, showing that it is possible to construct a payoff matrix that leads at least some persons to offer voluntary contributions even though those who refuse to contribute are allowed to consume the good once it is produced.

The central point in reaching this conclusion is that some who desire to consume such goods will volunteer to pay for them (even though noncontributors can free ride) if the benefits they expect to derive exceed the payment they offer and if they believe that the absence of their payment sufficiently reduces the probability of the good being produced. In such cases, there is an expected positive return to voluntary contributions.

What determines the likelihood that the required conditions would obtain? Jasay focuses on the size of the group of persons required to finance the public good (at a given contribution per person) relative to the size of the population of those who will consume the good if it is provided, arguing that private financing is more likely to succeed if this ratio is neither near zero nor near unity. If the ratio is near zero, that is if contributions from only a few

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people are needed to cover production cost, then potential contributors will be confident that enough others will make contributions. The result is a high probability of insufficient financial support. (Clearly, their anticipations are in error here.) If the ratio is near unity, that is, if almost all would-be consumers also need to be voluntary financers, each is likely to feel that private production is too unlikely to justify their making a contribution, because of their belief that there is a high probability that there will be some free riders. Somewhere in the middle range of ratios, depending on the assumptions made about contribution per person and cost of the good, it becomes likely that private production will go forward.

Jasay's conclusions in this respect, while plausible at one level, are not entirely convincing for three reasons. First, he offers no convincing explanation of what determines which people choose to become contributors and which to be free riders. There is an assignment problem here that is not resolved by Jasay, most of his analysis being based on the assumption that all members of the group are identical. If all are identical, it is difficult to say how they self-select into nonoverlapping groups of contributors and free riders. Their identicalness would seem to call for all to decide the same way. Jasay essentially relies on random selection to cope with the assignment problem. Yet, if there are to be voluntary contributors *and* free riders, there must be some analytical mechanism for sorting the group into these two categories.

Second, other considerations may affect the probability that the good will be produced privately. For example, Jasay assumes that a voluntary contribution to the financing of a good is costless if production ends up being stymied by there being too few volunteers; funds simply stay in, or costlessly return to, the pockets of contributors without their incurring information or transaction costs. But to the extent such costs really would be incurred, the range over which voluntary giving is likely to work is diminished. This criticism may be on the trivial side, but Jasay's rather exclusive focus on the ratio of number of needed contributors to number of users of the public good causes this reviewer some concern about other features of the problem that might affect the probability of its being solved privately.

Third, and most important, Jasay avoids the problem of elastic supply by imposing strong indivisibility conditions on the goods to be produced. A bridge either is built or it is not, and if it is built it is

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able to service all who would use it whether or not they voluntarily contributed to its financing. No questions of the size of the bridge, its strength, or the number of bridges to build are admitted. Jasay defends his heavy reliance on indivisibility and his belief that this does not significantly reduce the applicability of what he has to say. Thus, he points out that a bridge that only half spans a river is no bridge at all. To be a bridge it must reach both banks.

But bridges can be wider or narrower, stronger or weaker, few or many. Tolerance of free riding impedes the revelation of the knowledge required to make these choices. With elasticity of supply allowed to intrude into the problem, Jasay's purely voluntary solution, combined with tolerance for free riding, is very unlikely to lead to an efficient mix of the quantity and quality of public goods.

Jasay's single bridge may indeed be financed voluntarily by contributions from, say, only a third of the population, and these contributions may be forthcoming without resort to taxation. There is nothing more to supply because the bridge, by assumption, is sufficient to satisfy the total demands to be placed on it by contributors and noncontributors alike. But suppose the community seeks to place artistic sculptures within its boundaries, all of which may be viewed without congestion by all who wish to. If only a third of the population volunteers contributions, but if all equally enjoy viewing sculptures, the supply of sculptures purchased and made available to the public will be less than would be purchased if a costless exclusionary method were used to bar viewing by noncontributors. Where the good's supply is elastic, voluntary contributions on a nonexclusionary-use basis fail to deliver what may be judged the appropriate amount of public goods.

Put a bit technically, free riding prevents some demand (the free-riders' demand) for the public good from having an impact on supply of the good; the summation of demand from those willing to contribute voluntarily to produce the good is less than it would be if nonpayers' demands could be brought to bear on the production decision. To make Jasay's solution work, either the excluded demands must be rendered irrelevant because the voluntarily revealed demands bring forth enough of the public good—Jasay's indivisible good—or nonpayers must be excluded.

If exclusion is possible, we no longer need indivisibility to make a voluntary system work. If exclusion is impossible, Jasay's assumption about indivisibility becomes crucial to his voluntary-

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contribution solution. Perhaps it is possible to conceive of indivisibility being a relevant characteristic of goods, but I find it difficult to think of it as a serious possibility. Suppose a bridge must be of a certain width to service total demand for crossing it if no charge is levied. Voluntary contributions might be sufficient to finance such a bridge if those who most fervently desire its construction believe it will not be produced without their contributions *and* if they believe it offers a superior alternative to a somewhat narrower and cheaper bridge that creates a degree of congestion in its use.

Once the possibility of a smaller bridge is admitted, the indivisibility assumption is undermined, and so is the efficiency of Jasay's solution. To get the right-sized bridge, the total demand for its services should be reflected in the construction decision. In principle, this can be accomplished by barring nonpayers from using the bridge or by resorting to idealized state provision, but not by relying on private contributions in combination with free access to the bridge.

Thus, Jasay's assumption of a *given* indivisible good is fundamental to his solution, but I believe its adoption narrows considerably the scope of his solution. The good must be fixed in quantity and quality. This is a highly unlikely possibility. Even a foreign policy, considered as a public good par excellence, can be modified, improved upon, or weakened. At the least, it will be altered whenever the demands of additional persons are allowed to have their impact on its design.

Yet even Jasay's indivisible good does not escape the dilemma created by supply elasticity, for supply elasticity is implicit even in his preferred context. The fact that voluntary contributions may not yield sufficient funds to finance even the single unit of an indivisible good, though the total value of this unit exceeds the cost of supplying it, is a reflection of supply elasticity. The issue raised by this possibility is no different from that posed by a divisible good, although it is less obvious because of the either-or indivisibility context employed by Jasay. This weakness in Jasay's analysis undermines its ability to lay to rest the usual justifications for public production and/or exclusion of nonpayers.

Once fixity in quantity and quality of the good is abandoned, there is only one situation in which private supply on a free-access basis can yield an idealized proper outcome in principle. This case, however, requires an assumption that is not part of Jasay's model, an assumption of a strong distaste for overuse of the relevant good.

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Consider again the problem of constructing a bridge. We expect that the bridge that is built, if one is built at all, will reflect the nature and intensities of the demands of those who are willing to contribute voluntarily. Ordinarily, this may yield a bridge too small to be able to handle all crossings without congestion. But this congestion affects contributors and noncontributors alike. Would-be voluntary contributors may find the congestion so disagreeable that they willingly offer sufficient financing to build a bridge big enough to avoid all congestion rather than (1) court the possibility of doing without the bridge altogether, or (2) put up with the congestion that would accompany a smaller bridge. Here, even in the absence of Jasayan indivisibilities, if we make the additional assumption of a strong distaste for overuse of the good on the part of those who wish to have and to finance provision of the good, a principled idealized solution to public-goods production can be had through private means even though others are to be allowed to use it freely.

Of course, the most powerful reasons for relying on purely voluntary financing, accompanied by free access, may lie entirely outside the above line of discourse. State incompetence or bureaucratic malfeasance may make the state a poor provider of goods, and exclusion of nonpayers may be too costly to be practical. These reasons, which Jasay recognizes but chooses to set aside, may justify the nonexclusive voluntary provision of even those goods exhibiting considerable publicness in their supply conditions. I am sorry to say that these reasons are more convincing than is Jasay's contrived, narrow case for voluntary financing of such goods.

NOTES

1. Allowing additional persons to consume "a" public good may lead to a change in the good that is provided, such change being prejudicial to the preferences of others. Thus, allowing additional persons freely to view a broadcasted television program, although it does not deprive others of the ability to view this show, may lead producers to substitute a different show, one that caters more to the tastes of the broader audience. When this is the case, free access does impose a cost on those who have different preferences. See Jora R. Minasian, "Television Pricing and the Theory of Public Goods," *Journal of Law and Economics* (1964): 7.
2. For an early discussion of these two aspects of the problem of private provision of goods, see H. Demsetz, "The Private Production of Public Goods," *Journal of Law and Economics* (October 1970).

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David L. Prychitko

FORMALISM IN AUSTRIAN-SCHOOL WELFARE ECONOMICS: ANOTHER PRETENSE OF KNOWLEDGE?

Contemporary Austrian-school economists reject neoclassical welfare theory for being founded on the benchmark of a perfectly competitive general equilibrium, and instead favor a formal theory deemed consistent with the notions of radical subjectivism and disequilibrium analysis. Roy Cordato advances a bold free-market benchmark by which to formally assess social welfare, economic efficiency, and externalities issues. Like all formalist, a priori theory, however, Cordato's reformulation cannot meet its own standards, being theoretically and empirically flawed, and perhaps ideologically suspect.

> The hidden order, harmony, and efficiency of the voluntary free market, the hidden disorder, conflict, and gross inefficiency of coercion and intervention—these are the great truths that economic science, through deductive analysis from self-evident axioms, reveals to us.
>
> —Murray N. Rothbard[1]

> It would be inappropriate to conclude that those Austrian approaches to welfare economics have simply been ex post rationalizations for some ideologically desired result. It is arguable that these conclusions regarding insti-

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> tutional efficiency are an inevitable consequence of consistently following the constraints imposed by Austrian methodology. The consistent focus on individual goal seeking, a theme of Austrian analysis beginning with Menger, coupled with the analytical constraints of radical subjectivism, may necessarily lead to [laissez faire] or something close to it, as an institutional touchstone for normative analysis.
>
> —Roy E. Cordato[2]

Welfare economics, for all its rigor, is in trouble. The hope of developing a scientific benchmark by which to judge economic efficiency and social welfare, one that claims consistency, objectivity, and relevance, has been dashed. The so-called New Welfare Economics—which held so much promise during Paul Samuelson's tenure[3]—accomplished a technical feat that was nothing short of brilliant. But terrific technics produced poor praxis, and today's top welfare specialists, such as Amartya Sen, have rejected many of the foundations of New Welfare Economics in favor of cardinal, interpersonally comparable utility.

Neoclassical welfare economics has failed to provide a viable, and relevant, foundation by which to assess efficiency, growth, and well-being in actual economic systems. It is a large leap from the realm of pure theory—say, Pigouvian externalities models—to determining, as an applied economist, an optimal Lindahl tax price. The question of how to calculate the tax on free riders of public goods, or on polluters, in order to achieve a more efficient allocation of scarce resources, cannot be consistently answered by the neoclassical framework that gives rise to those questions. If actual market economies fail to achieve general economic equilibrium, then the going market prices do not reflect underlying marginal costs and benefits—neither socially nor privately. Neoclassical welfare theory cannot objectively and consistently ground the analyst, who has no way of measuring, for example, people's marginal rates of substitution in consumption, let alone predicting the intended and unintended consequences of a given policy scheme.[4]

What of alternatives to neoclassical welfare economics? Austrian-school economists are eager to present their views as remedying the deficiencies of the mainstream. Does Austrian welfare economics allow us to make meaningful, value-free, empirically rich statements regarding economic efficiency and social welfare?[5] I will try to show that Austrian welfare theory, much like its

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neoclassical counterpart, cannot meet the canons of formal, a priori theory.

Austrian Criticism

Austrians reject neoclassical welfare economics because it centers on the concept of general economic equilibrium, which requires appallingly unrealistic assumptions. These include, among others: 1) atomistic individualism, whereby each agent is modeled as a cultural eunuch, free from traditions, customs, personal relationships, and nonpecuniary interests; 2) perfect information, under which agents make perfectly rational utility-maximizing and profit-maximizing choices, knowing with full certainty the opportunities and constraints they face, and the consequences of their actions; 3) price-taking behavior, whereby product and input prices are treated as parameters that cannot be influenced or manipulated by individual actors; 4) perfect competition, whereby rivalry over monetary profit is completely exhausted, and institutions that enable people to cope with uncertainty—such as money, firms, capital accounting—are assumed away; and 5) equilibrium prices that fully capture marginal costs and benefits, turning subjective assessments of utility and cost into objectively measurable data.

An economy under general equilibrium (assuming appropriate convexity conditions) is considered efficient by neoclassical standards because it fully exhausts opportunities for mutually beneficial exchange, and by definition is Pareto optimal: any redistribution of resources would make at least one party worse off. Since every agent is maximizing utility, social welfare is also maximized.[6] The free-market system is said to maximize efficiency and welfare as long as the five conditions just listed (and others) apply. When general economic equilibrium is not achieved, however, a given distribution of resources may accordingly be deemed inefficient. Thus, under perfectly competitive conditions, more airline companies, stable prices, and other desirable features might supplant the market failures of the current airline industry. Monopolies, oligopolies, externalities, and public goods are widely held to be examples of market failure. The presence of nonpecuniary interests, quasi rents, and institutions designed to cope with ignorance are less obvious examples.

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But how meaningful is the general equilibrium benchmark? Austrians argue, rightly in my opinion, that no real-world economy could achieve general economic equilibrium. It is safe to say that no society in the past, present, or relevant future can be characterized by the five conditions above. Indeed, many of the activities that a neoclassical economist deems market failures are, in fact, what the market process is all about. For example, real entrepreneurs aren't "price takers": they engage in arbitrage (buying low and selling high), they discover new ways of satisfying consumer demand, they engage in rivalry. So the issue is not only whether free-rider problems or pollution externalities or even monopolies occur in actual capitalist economies. As long as uncertainty prevails, or entrepreneurial profits and losses occur, or even personal relationships exist, the economy is in disequilibrium and, if we remain true to the foundations of neoclassical economics, all actually existing economies must be judged inefficient, if they are to be judged at all. Austrians reject that conclusion because they reject the analysis. Of course, many neoclassical economists also reject that conclusion, and defend some policies and institutional arrangements as being more efficient than others (a monetary rule instead of discretionary monetary policy, for example, or airline deregulation rather than regulation, or the North American Free Trade Agreement rather than traditional protectionism). But neoclassical economists who make empirical welfare or efficiency claims about particular market processes are inconsistently applying their otherwise rigorous theory.[7]

This, perhaps, may help us better understand Frank Hahn's recent criticisms of applied neoclassical economics. Hahn, an eminent neoclassicist himself, is unwilling to overlook the blatant inconsistency of applied equilibrium theory or downplay its paucity of empirical content. According to Hahn, the role of general equilibrium theory is (or should be) very narrow: it addresses the question of whether or not a model decentralized economy composed of isolated agents who rely purely on price signals for utility and profit maximization can lead to a perfect coordination of plans. Happily, the answer is yes. Mathematical economics has shown that such an equilibrium exists (i.e., it has a determinate mathematical solution) and that the model decentralized economy will tend to converge upon a perfect coordination of plans.[8] For Hahn, one is mistaken to believe that general equilibrium describes any existing

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economy. General equilibrium is nothing more than an abstract answer to an abstract question. To even claim that actual free-market economies tend toward general equilibrium (or to say that some economies—the U.S. economy, for example—is "closer" to general equilibrium than others—that of Bangladesh, for example) is theoretically unfounded: the tendency toward equilibrium has been demonstrated only under very extreme, and empirically unrealistic, assumptions such as perfect information, ergodicity, and so on. If participants in real-world economies face true uncertainty, or if they lack perfect information, or if indivisibilities exist, then at least some of the necessary conditions for convergence are violated, and the best one could say is that the real world is in disequilibrium.

This lack of realism is the price paid by neoclassical economic theory in order to achieve value freedom, logical rigor, and theoretical coherence. Of course, in order to study real existing economies, many neoclassical economists depart from the assumptions necessary to meet such formalist criteria. In a sense, Hahn's insistence on upholding neoclassical formalism requires neoclassical economists to shut up when it comes to questions about real existing economies.

Austrian-school economists contend, by contrast, that their methodology—deductive analysis from self-evident axioms—avoids Hahn's problem. They claim to offer an alternative method upon which to ground welfare economics. They claim their theory is founded on empirically true assumptions, that they describe real phenomena, that their welfare conclusions are value free, coherent, and empirically meaningful. They claim to avoid the problems of neoclassical welfare economics. Do they—or perhaps, as one educated in this tradition, I should ask: do we?

The Formalist Temptation about Preferences: An Austrian Case Study

In "Toward a Reconstruction of Utility and Welfare Economics," Murray Rothbard offered the first extended Austrian criticism of the (then) New Welfare Economics and, more importantly, an alternative foundation for welfare theory.[9] Since Roy Cordato's *Welfare Economics and Externalities in an Open Ended Universe: A Modern*

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Austrian Perspective (Boston: Kluwer, 1992) is strongly influenced by Rothbard's approach, it is worth taking a close look at Rothbard before turning to Cordato himself.

Rothbard's version of Austrian welfare economics is grounded in the praxeology of Ludwig von Mises. For Rothbard, as for Mises, it is incontestably true that humans act instrumentally (by arranging means to attain ends). Praxeology, a formal theory of human action, deduces logical implications from the action axiom. Rothbard claims that whatever is logically deduced from that axiom is absolutely and universally true.[10] Since, for Rothbard, the initial axioms are "radically empirical," so, too, is the body of praxeological theory. Hence, the theoretical claims that Rothbard makes about the welfare-generating aspects of a market economy are at once apodictic *and* empirical, an epistemological status unrivaled by even the most sophisticated neoclassical welfare theory. "It is the praxeologist who is truly empirical," proclaims Rothbard, "because he recognizes the unique and heterogeneous nature of historical facts; it is the self-proclaimed 'empiricist' who grossly violates the facts of history by attempting to reduce them to quantitative laws."[11]

Rothbard's welfare economics can be summarized quite easily: action implies choice among alternatives. In acting so as to arrange scarce means to attain ends or goals, individuals will always act in a manner that will satisfy, ex ante, the ends or goals they value most highly. As a subjectivist, Rothbard argues that we cannot know the exact construction of each individual's scale of preferences. What we do know, scientifically (or praxeologically, which, he contends, amounts to the same thing), is that people *demonstrate their preferences* in concrete, voluntary acts of choice. (A student majoring in economics, for example, demonstrates his preference over all other subjects of study available to him at the time of declaration. A Sunday morning churchgoer demonstrates that she prefers the sermon to an extra hour of sleep. Your subscription to the *Times* shows you prefer it to the *Post*.) Thus, there is no need to reify tastes and preferences in terms of neoclassical indifference curves, which are empirically empty hypotheses.

Rothbard's notion of demonstrated preferences reconciles his claim that value, utility, and opportunity cost are inherently subjective with his desire to make objective, empirical claims about

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people's preferences. As long as the action is voluntary, individuals always and necessarily maximize utility, at least ex ante.

"This concept of preference, rooted in real choices," Rothbard believes, "forms the cornerstone of the logical structure of economic analysis, and particularly of utility and welfare analysis."[12] Demonstrated preference theory differs explicitly from Samuelson's formal notion of revealed preference in that Rothbard rejects Samuelson's assumption of constant tastes and preferences, which has no empirical justification.[13]

The move from each acting individual to overall social welfare occurs swiftly in Rothbard's analysis: because the free market is simply equated with the entire array of voluntary exchanges among individuals,[14] logic dictates that it necessarily benefits all of its participants:

> The very fact that an exchange takes place demonstrates that both parties benefit (or more strictly, *expect* to benefit) from the exchange. The fact that both parties chose the exchange demonstrates that they both benefit. The free market is the name for the array of all the voluntary exchanges that take place in the world. Since every exchange demonstrates a unanimity of benefit for both parties concerned, we must conclude that *the free market benefits all its participants*. In other words, welfare economics can make the statement that the free market increases social utility, while still keeping to the framework of the [Paretian] Unanimity Rule.[15]

Thus, by equating individual choices with social utility, Rothbard concludes that the free market maximizes it; "and we can say this with absolute validity as economists," Rothbard claims, "without engaging in ethical judgements" or interpersonal utility comparisons.[16] Moreover, Rothbard argues, the free market not only maximizes ex ante utility, but, because of its competitive nature and incentives to satisfy urgent demands efficiently, it tends to maximize ex post utility as well.[17]

Rothbard's approach apparently offers real solutions to neoclassical problems, solutions that are coherent, value free, and empirically relevant. He avoids untenable neoclassical assumptions about quasi-concave social utility functions and the like, and he thinks he comes to terms with the real heterogeneity of history, the world of real choices.

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Competitive Jealousy and Psychic Loss

Let us reexamine Rothbard's claim that a free market necessarily maximizes ex ante social utility. Isn't it possible to conceive of third parties to voluntary exchanges who, through fear, jealousy, envy or other common emotions, feel their situation worsened by those exchanges? (Consider a yuppy who, having finally achieved his ambition to own a BMW, becomes truly depressed when he discovers that his neighbors have dumped their BMWs for Ferraris.) Doesn't this happen frequently in actual market processes, where people are strongly motivated by desires to consume conspicuously and compete positionally?[18] Rothbard's answer to these criticisms (which were first raised by Melvin Reder)[19] is so clear, so simple, and so troubling that it deserves reproduction in full:

> But what about Reder's bogey: the envious man who hates the benefits of others? To the extent that he himself has participated in the market, to that extent he reveals that he likes and benefits from the market. And we are not interested in his opinions about the exchanges made by *others*, since his preferences are not demonstrated through action and are therefore irrelevant. How do we *know* that this hypothetical envious one loses in utility because of the exchanges of others? Consulting his verbal opinions does not suffice, for his proclaimed envy might be a joke or a literary game or a deliberate lie.[20]

In his search for apodictic certainty, Rothbard summarily rejects the possibility of anomalies in his position. Because we "have no ironclad proof" that those suffering psychic harm are not simply joking, telling lies, or playing sick mental games, then any "person's 'envy,' unembodied in action, becomes pure moonshine from the praxeological point of view."[21] Rothbard seems to assume that the "praxeological point of view" has a monopoly on social knowledge: therefore, he is entitled to reject all knowledge claims that cannot be deduced from first premises regarding action and demonstrated preference. Although he claims his formal theory is empirical—in fact, radically empirical—it provides no room for the very real people who, rationally or not, become frustrated or harmed and suffer utility losses in actual market processes.[22]

Thus, despite Rothbard's rejection of positivism, his own demonstrated preference theory is thoroughly positivistic (or, better, behavioristic). As he would later write, "we may know as historians, from interpretive understanding of the hearts and minds of

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envious neighbors, that they do lose in utility. But we are trying to determine . . . precisely what scientific economists can say about social utility or can advocate for public policy, and since they must confine themselves to demonstrated preference, they must affirm that social utility has increased."[23] But if indeed we *can* learn something from history, as Rothbard suggests, then why discard that knowledge when we undertake scientific economics? Because of its source? Because it is not gained through a priori deduction alone? One suspects that the praxeological formalism to which Rothbard aspires rests upon a questionable view of science: we only scientifically "know" that which can be deduced from "absolutely true" axioms.

Whether Rothbard's welfare theory is a meaningful alternative to the mainstream depends, in part, on how well it can be applied to the pressing public policy issues of our time. Actual public policy questions occur in a specific time and place—that is to say, in *history*—so it does matter that some people will probably be psychically harmed with the introduction of freer markets—if one wants to analyze the effects of free markets on overall social utility. Rothbard's use of "must" above is simply dogmatic, and suggests that his welfare economics might not be able to cope with the empirical complexities of actual policy analysis. If an actual public policy (say, NAFTA) is likely to impose a loss of utility on some (say, thousands of U.S. factory workers who might be fired as a result of its enactment), and if we admit that indeed we "know as historians" that they will lose in utility, then to ignore this knowledge and insist instead that, according to formalist criteria of science, social utility will necessarily *increase* is simply doctrinaire.

The Extraordinary Claims of A Priori Welfare Theory

Even if we presume that Reder's challenge is met by praxeology, the additional claim Rothbard makes about social welfare under interventionism—specifically, that no state intervention can ever increase social utility—is a careless self-contradiction.

His argument runs as follows. The free market maximizes ex ante social utility because it is nothing more than a nexus of voluntary trades. For the state to disrupt this nexus by, say, prohibiting two people from engaging in mutually beneficial trade, will make

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both parties worse off. The only one who gains utility is the state official(s) who demonstrated a preference for intervention. "As economists," Rothbard concludes, "we can therefore say nothing about social utility in this case, since some individuals have demonstrably gained, and some have demonstrably lost in utility, from the governmental action." Rothbard suggests that we should be agnostic here. Moreover, if the state forces two individuals to make a trade in a way they would not have done voluntarily, then at least one of the individuals is worse off, while the government official(s) gains utility. "Again," Rothbard argues, "economics can say nothing about social utility in this case." Again, we must remain agnostic: we simply don't know.

Yet his next sentence reads: "We conclude therefore that *no government interference with exchanges can ever increase social utility*." In fact, he goes so far as to proclaim that "since some lose by the existence of taxes, therefore, and since all government actions rest on its taxing power, we deduce that: *no act of government whatever can increase social utility*."[24] Somehow Rothbard has leapt from agnosticism to certainty: the state definitely cannot increase social utility. His italics suggest we take his claim seriously, as an apodictic truth. But it's more apoplectic than apodictic.

Rothbard's conclusion directly contradicts his claims that Austrian welfare economics "can say nothing" about social utility under state intervention. Rothbard now suggests that value-free science condemns *all* state intervention as utterly unable to increase utility. How does this claim logically follow from his own framework? It cannot, unless he inserts an implicit assumption—his libertarian "nonaggression axiom"—to complete the step from agnosticism to certainty.[25] While such an insertion may plug the gap in Rothbard's logic, it contradicts his stated intention to produce a value-free welfare economics; surely it violates Rothbard's formalist canons to clinch his indictment of state intervention by means of a value-laden deontological libertarian ethic.[26]

If Rothbard's formalism cannot consistently answer the question of whether ex ante social utility rises or falls in simple hypothetical thought experiments (such as the one that Reder suggested), how can it possibly be expected to help assess the complex questions raised by actual state interventions and externalities?

Equally problematic is Rothbard's claim that the market process both maximizes ex ante social utility *and* tends toward equilibrium.

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His welfare analysis explicitly rejects the notion of constant tastes and preferences, but his claims about the free market's equilibrating tendencies requires constant tastes and preferences. Rothbard makes it clear that since general equilibrium implies unchanging value scales, static technology, and so on, we can say the market process tends toward equilibrium only as long as we hold value scales and technology constant.[27] To the extent that a welfare economics grounded in demonstrated preferences rejects the notion of constant tastes, Rothbard cannot claim (however tenuously) that the market process both maximizes ex ante social utility and tends toward equilibrium, for the assumptions required for him to make the welfare claim are inconsistent with those required for the tendency claim.

My criticism is immanent: as a formalist who asks that his claims be tested only by their logic,[28] Rothbard's ultimate conclusions about state intervention do not follow. To achieve coherence, Rothbard must rely on natural-rights libertarianism, which is not only dubious in itself, but necessarily violates Rothbard's stricture (which is the basis of his critique of the neoclassical alternative) that welfare economics be completely independent of value judgments if it is to be a science at all. This formalism allows Rothbard to ignore utility losses due to envy, power, positional competition, poverty, even inept entrepreneurship. But there is nothing self-evident about Rothbard's assumption that "purely" theoretical, ahistorical knowledge exhausts the realm of science.

A New Form of Welfare Theory?

Roy Cordato's recent *Welfare Economics and Externalities in an Open Ended Universe* is something of a landmark in Austrian economics. It is the first book-length Austrian attempt to provide an alternative paradigm to neoclassical welfare theory by creating a general theory of welfare and efficiency that is "divorced from perfect competition or any notion of general equilibrium" (1).[29]

It is also marked by the author's refreshing discomfort with the Rothbardian framework. Cordato offers the following criticisms of Rothbard's demonstrated-preference approach: (1) Rothbard fails to include psychic utility losses in his free-market benchmark; (2) Rothbard ignores the problem of interpersonal utility comparison:

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"In order to conclude that a market exchange unambiguously increases 'social utility,'" writes Cordato, "the effects on everyone's satisfaction must be considered and compared, even those whose preferences are not being demonstrated" (43); (3) Rothbard studies only ex ante utility effects, and "rules out all consideration of costs and therefore the possibility of utility loss" (43), which, in effect, implies that (4) Rothbard constructs "an error free world of perfect knowledge, where expectations necessarily coincide with results. . . . He rules out the possibility of utility loss in constructing his model" (43)[30]; (5) Rothbard's framework is ultimately static, and leads him to "conclusions with regard to both individual and social welfare that are obviously incorrect" (44).[31] Concerning externalities, for example, "a strict [Rothbardian] interpretation would have to conclude that any harms or benefits that are not demonstrated do not actually exist," which seems preposterous. "In light of these criticisms," Cordato concludes, "Rothbard's welfare economics does not offer much promise as a general guide for externalities theory or policy" (44).

Despite these promising sentiments, unfortunately, Cordato is not interested in revamping (let alone rejecting) Rothbard's demonstrated preference theory; he wishes to merge it with his neo-Kirznerian assertion that the market process is at once efficient and equilibrating, in order to provide, finally, a general Austrian theory of efficiency and welfare. The key to doing so is found in Cordato's contribution of a new concept, "catallactic efficiency."

Cordato acknowledges that this concept requires the "wholesale adoption" of Israel Kirzner's theory of individual efficiency, but adds that the individual faces a more "open-ended" knowledge problem than Kirzner allows. Indeed, since Cordato wants to create a welfare economics that is divorced from any notion of general equilibrium, one would expect him to have trouble with Kirzner's approach. What, then, is Cordato's criticism of Kirzner?

Kirzner's notion of a perfectly coordinated general equilibrium leads him to claim that improvements in knowledge are always both equilibrating and coordinating. But Cordato notes that "while knowledge improvements may be equilibrating, in that, ceteris paribus, they move us closer to a world of 'perfect knowledge,' they may not always be strictly coordinating" (52). For example, a successful entrepreneur may unintentionally frustrate some people's plans (e.g., those of his competitors), at least in the short

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run, in the process of profiting from his coordination of the plans of others (e.g., his customers). Cordato, in making this loosely Schumpeterian argument, is justifiably troubled with Kirzner's claim that each step in the competitive process must be, overall, a step toward greater plan coordination. But Cordato agrees with Kirzner that the logic of this process *is* always *knowledge-enhancing*: market participants continuously learn from their successes and failures, and thus the market process, while not strictly coordinating in the short run, is in the long run a strictly equilibrating process, as it tends toward, but never reaches, a world of perfect knowledge. "Since the entrepreneurial process is always knowledge enhancing, even though at different stages it may be discoordinating, my conclusion is Kirznerian in that I believe entrepreneurship is always equilibrating but may not always be coordinating" (55n7).

Cordato contends that the equilibrating tendency of entrepreneurship provides a "partial benchmark" and "logical starting point" for a thoroughgoing Austrian welfare theory. This contradicts Cordato's expressed hope to provide a welfare economics divorced from any notion of general equilibrium (e.g., 1, 4, 5, 15, 19, 36, 73). After all, to claim that market processes tend toward (but never quite reach) equilibrium necessarily requires a clearly developed notion of general economic equilibrium. Morever, in claiming that a catallactically efficient market continuously generates new knowledge, but doesn't continuously coordinate individual plans, it is hard to discern what *type* or *kind* of knowledge Cordato has in mind. To be sure, the market produces some forms of new knowledge. But so do the state, the household, the Elks Lodge, the Little Sisters of the Poor, and all other institutions.

Cordato also differs from Kirzner in recognizing that tastes and preferences change continuously in light of new knowledge (60, 62; cf. 70). But this insertion of "open-ended" knowledge into a Kirznerian framework leaves Cordato hard pressed to show that the market is still strictly equilibrating. Indeed, for all his references to open-ended knowledge, Cordato does not come to terms with the complexities of such knowledge or the possibility of its varying qualities; he fails to explain precisely how and why market processes continually generate the type of knowledge that would create efficiency and tend to converge toward equilibrium. At best, he simply asserts that market prices and rivalrous competition will

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provide as much of this knowledge as possible (e.g., 21, 64, 67, 69, 82, 97–98). To claim, as he does, that the market is therefore "equilibrating," but not necessarily coordinating, is a tautology at best.

One may infer that Cordato must mean by "knowledge" information about matters that will help individuals satisfy their own plans, that is, knowledge that enhances *coordination*. Cordato invites this interpretation by claiming, for instance, that a market system promotes catallactic efficiency "to the extent to which the catallaxy encourages individuals existing in a social context to pursue their own goals as consistently as possible" (62). This sounds like enhanced coordination. Elsewhere he writes: "Mutually agreed upon market prices will reflect as much information about market participants' preferences, expectations, and perceptions of resource scarcities as possible" (67). This, too, sounds like the type of knowledge that better coordinates, rather than disrupts and discoordinates, individual plans. Cordato even goes so far as to claim that "all of Kirzner's concerns with regards to the individual's means-ends framework and the ability of the price system to capture and disseminate accurate information are embraced within this theory of catallactic efficiency" (70). Similar assertions resound throughout the book. But they remain assertions, since Cordato offers no scholarly demonstration (theoretical or empirical) of their validity.[32]

Despite his appeal to "open-ended" knowledge, one wonders if Cordato's "catallactic efficiency" concept has added anything new to Kirzner's analysis.[33] Although he "rejects" equilibrium-based analysis, he suggests that there are convergence (equilibrating) tendencies in the traditional sense; that is, the market produces not merely new knowledge, but precisely the type of knowledge that leads to ever greater coordination of individual plans. Can such a "rejection" of equilibrium analysis offer any solutions to the potential problems in Kirzner's equilibrium-convergence theory?[34] On the other hand, if Cordato does not really intend to claim that the market process fundamentally converges toward general equilibrium, in the traditional sense of full plan coordination, then, at best, we are left with his uninteresting claim that markets generate "knowledge," and one wonders how Cordato can deduce a priori the efficiency of the market process on the basis of that claim alone. While Cordato might have tried to come to terms with a Post Keynesian kind of "open-endedness," one that employs radical sub-

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jectivism *and* suggests a fundamental indeterminancy of economic processes,[35] he completely ignores the issue.

The Return of Radically Subjectivist Formalism

Cordato's (undemonstrated) case for the catallactic efficiency of the market process provides a (very shaky) bridge to his additional claim that markets increase social welfare because market participants find it easier to satisfy their plans than they would in alternative institutional settings (62–64). Cordato similarly contends that social welfare is not reduced in the presence of simple negative externalities. Yet Cordato believes that traditional welfare-theory notions of "social" benefits and costs are unfounded: they are "not only arbitrary, but simply fabrications of the economist's mind" (111; cf. 43, 59, 65, 78, 81, 87). He therefore rejects interpersonal utility comparisons and embraces a radically subjectivist methodology, whereby "the full implications of subjective value are taken seriously" (111; cf. 4, 87). Cordato attempts to reconcile his welfarist claims with his repudiation of neoclassical welfare theory by turning to Rothbard's theory of demonstrated preference:

> The two fundamental tenets of Austrian economics, methodological individualism and subjectivism, must be part of any operational theory of efficiency.
>
> In conjunction with and as an implication of subjectivism, any analysis of people's preferences must be based on a recognition and acceptance of the guiding principle behind Rothbard's theory of social utility, i.e., revealed or "demonstrated" preference. Since the economist cannot project a value scale onto individual actors within the catallaxy, preferences can only be deduced by observing activities. Furthermore, since states of knowledge can and do change with the passage of time, preferences that are revealed at a point in time cannot be assumed to remain constant over time. Again, this is an important part of Rothbard's analysis that can and should be used as a building block for the theory being presented here. (59)

How does Cordato propose to square his reliance on Rothbard with his earlier criticisms of Rothbard's position? As far as I can tell, he fails even to try to do so. One searches in vain for any fundamental differences between Cordato's ultimate position and Rothbard's. True, Cordato does mention that his own theory rests on imperfect knowledge, and he tries to come to terms with the

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dynamics of an "open-ended universe," but this does not create an iota of difference between the two authors' embrace of demonstrated preference analysis. On the basis of this analysis, Cordato fundamentally agrees with Rothbard's conclusion that "no government interference with exchanges can ever increase social utility. . . . Whenever government forces anyone to make an exchange which he would not have made, this person loses in utility as a result of the coercion" (Rothbard quoted, 87). Whatever became of Cordato's earlier conclusion that Rothbard's position is "obviously incorrect"?

Cordato's equivocation is evidenced in his repeated references to a hypothetical home owner, A, who stores junk cars in his back yard, upsetting his next-door neighbor, B. This hypothetical is first raised in order to explicate Rothbardian welfare economics. As Cordato recognizes, a Rothbardian would have to conclude that there is no way to enhance welfare in this example by means of intervention: "Since the satisfaction levels of A and B cannot be observed or measured," writes Cordato, "it would be meaningless for any outside observer to compare A's utility losses to B's utility gains. In fact, there would be no way of knowing an externality even exists" (17). At this point, it is hard to say whether Cordato approves or disapproves of the Rothbardian position.

Cordato explicitly criticizes Rothbard the second time he considers this story (Cordato now unwittingly places the junk cars on A's front lawn). Cordato argues that

> if only external effects that are demonstrated can be evaluated by Rothbard's normative criteria, a strict interpretation of his approach would have to conclude that any harms or benefits that are not demonstrated do not actually exist. For instance, an example of a negative externality that does not involve a violation of property rights was discussed in chapter 1. In this example, individual A imposed psychic harm on his neighbor, individual B, by storing junk cars on his front lawn. As was pointed out, the standard Austrian conclusion with respect to this type of situation is that a nonvoluntary remedy to this problem could not unambiguously improve social welfare. But if Rothbard's welfare criteria were guiding the analysis the fact that an externality was even being generated would have to be denied.
>
> In light of these criticisms [(1)–(4) above] Rothbard's welfare economics does not offer much promise as a general guide for externalities theory or policy. His approach begs many of the questions that would have to be answered if an analysis of externalities were to be considered complete. (44)

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Yet by the time Cordato resurrects the story a third time (now being considered in light of Cordato's own general welfare economics), he draws exactly the same conclusion for which he earlier chided Rothbard:

> First, it should be pointed out that from a strictly subjectivist perspective, the presence of such externalities would be unverifiable by an outside observer, such as a policymaker or an economist. There is no way of telling what the actual impact of such an effect is on the utility of those living in the neighborhood; no way of knowing whether such effects are necessarily negative. For example, other older car enthusiasts or automobile hobbyists in the neighborhood may find such circumstances aesthetically pleasing. For them the cars on their neighbor's lawn could represent a positive externality. Furthermore, even if utility were observable, in cases where cars might be generating both positive and negative effects, there is no way of telling, since utility is not comparable, whether, on net, they represent a positive or negative externality.(81)

This final oscillation leads Cordato straight into Rothbardian dogmatics. In the real world, the one that Cordato claims to address, we can usually learn with relatively little trouble whether or not people dislike junk cars on a neighbor's lawn. They may dislike it so much that they volunteer the information (to the owner, the local government, etc.). Or we can ask them. But these options fail to meet the formalist criteria of knowledge: Cordato asserts that we have "no way of knowing"; for as Rothbard warns us, we have no "ironclad proof."

It is true, of course, that we have no unambiguous or apodictic method for measuring the costs (or benefits) imposed on (or donated to) the neighbors. The real world is a terribly fuzzy place. But acknowledging this does not justify Cordato's absurd statement that we have no way of learning who is harmed by an externality and who isn't. The *unmeasurability* of utility gains and losses in no way entails their complete *inaccessibility* to analysis.

If utility gains and losses *were* inaccessible, however, then Cordato would be unable to claim that his framework can scientifically assess the costs of alternative degrees of state intervention in the market.[36] Cordato cannot have it both ways: if costs and benefits are so fundamentally subjective that we cannot even know if an externality is present, then we can hardly know if an intervention is more costly than beneficial, or that, in general, a free market is the

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"ideal institutional setting" (IIS) for maximizing efficiency and social welfare. Yet he writes that

> it seems that . . . the IIS will be the logical outcome of any comparative institutions analysis done from an Austrian perspective, regardless of the specific definition of efficiency guiding the analyst.
>
> When externalities are viewed in light of the IIS the Austrian conclusions as originally put forth by Mises are automatically implied. Only externality "problems" that involve the conflicting use of property are inconsistent with that institutional arrangement. . . . The point is that the general normative analysis of externalities found throughout the Austrian literature can be interpreted as an attempt to establish or maintain a widely agreed on "ideal" institutional arrangement. In addition, viewing the analysis from this perspective gives it an overall coherency that cannot be seen when discussing it strictly from the perspective of any of the separate welfare criteria. (88)

Cordato's welfare economics imports the most untenable features of Rothbard's theory. While Cordato criticizes Rothbard for implicitly accepting some type of perfect knowledge assumption, he fully accepts the bulk of Rothbard's demonstrated preference theory, which is theoretically incoherent, if not largely ideological. And while Cordato tries to criticize Kirzner for arguing that the market process continuously coordinates plans, he must ultimately side with Kirzner's claim that the market process is fundamentally equilibrating and efficiency enhancing. If Cordato has done anything new, he has used Kirzner's convergence theory as a way to save Rothbardian welfare conclusions.

A Farewell to Formalism in Welfare Theory?

Cordato (like Rothbard before him) believes he deduces laissez-faire capitalism as the ultimate benchmark for normative welfare analysis. He concludes, in the comfort of pure, a priori theory, that only free markets can increase social welfare and efficiency, that deviations and interventions which restrict free-market processes necessarily reduce welfare and efficiency. He does not seem to realize that these are empirical claims that require detailed, historical case studies. As a formalist, he thinks such studies unnecessary. Like Rothbard's, Cordato's claims are said to be deduced from self-evident axioms, his conclusions are perhaps even "an inevitable consequence of consistently following the constraints imposed by

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Austrian methodology" (87). ("Constraints" is a very interesting word choice.)

But, if my argument is correct, Austrian welfare economics does not provide any solutions to the problems of neoclassical welfare economics. It, too, is inconsistent, value laden, and empirically questionable. It, too, fails to live up to its own formalist criteria—which could not sustain, without careful historical study, the assertion that any and all acts of the state necessarily diminish social welfare (even though one may have good reasons to believe that envy may lead to disutility, or that people are indeed harmed by negative externalities, or even that a dollar may provide more utility to a homeless person than to the millionaire to whom it legally belongs). While their formalism allows them to argue that we must dismiss this knowledge and instead uphold a naive relativism on such issues in the absence of "ironclad proof," neither Rothbard nor Cordato has ironclad proof that the market process maximizes social utility and catallactic efficiency, or that any act of the state necessarily reduces utility and efficiency, or even that their methodology or choice of tenets is the most appropriate way to address welfare questions. Austrian-school welfare economists have tried to offer apodictic knowledge by appealing to the formal and a priori epistemological status of praxeological theory, but have failed to meet their own standards.

Put differently, if the "constraints" of Austrian formalism demand of its practitioners that they uphold value relativism, then they also demand that Austrians embrace the same relativism (or nihilism) about the effects of markets and states upon social welfare and efficiency (at least until all the inconsistencies and value-laden arguments are jettisoned, so that what remains can truly enjoy apodictic status). Failing to do so amounts to an unwarranted "pretense of knowledge."

If, on the other hand, one rejects relativism, it may be necessary to conclude that the effort to create a grand, conclusive, relevant welfare theory through formal a priori reasoning alone probably hinders, rather than enables, a truer understanding of society. Perhaps formalist philosophies of science (whether Austrian, neoclassical, or other) are questionable in themselves, and perhaps should be abandoned, because they unnecessarily constrain the chances for better argument, improved dialogue, and greater empirical relevance.

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NOTES

1. Murray N. Rothbard, *Man, Economy, and State*, vol. 2 (Los Angeles: Nash, 1970), 880.
2. Roy E. Cordato, *Welfare Economics and Externalities in an Open Ended Universe: A Modern Austrian Perspective* (Boston: Kluwer Academic, 1992), 87.
3. See Paul Samuelson, *Foundations of Economic Analysis* (Cambridge, Mass: Harvard University Press, 1983 [1947]), esp. chs. 7–8.
4. The Pigouvian norm in standard welfare economics is theoretically inconsistent. Under conditions of general competitive equilibrium, which necessarily presume an absence of externalities, prices equate and objectively measure marginal benefits and marginal costs. There is no need to distinguish between "private" marginal costs or benefits and "social" marginal costs or benefits. In this way general equilibrium prices allow for an objective assessment of costs and benefits. In the event of an externality—say, a profit-maximizing firm that pollutes and ignores the costs it imposes on others—general competitive equilibrium is not achieved. Hence, the problem becomes more than a divergence between "private" and "social" costs (generated by the externality). Because the system is now outside general equilibrium, the prevailing disequilibrium prices fail to objectively measure private costs and benefits (marginal rates of substitution can no longer be unambiguously compared). It is theoretically inconsistent, then, to presume that the internal and external costs can be objectively measured and that an efficient corrective tax can be formulated. See James M. Buchanan, *Cost and Choice: An Inquiry in Economic Theory* (Chicago: University of Chicago Press, 1969), ch. 5. Karen Vaughn develops this criticism further in "Does It Matter that Costs Are Subjective?" *Southern Economic Journal* 46, no. 3 (January 1980): 702–15. For the value-laden and ideological underpinnings of traditional welfare economics, see Gunnar Myrdal, *The Political Element in Economic Theory* (New Brunswick, N.J.: Transaction, 1992); and Amartya Sen, *On Ethics and Economics* (New York: Basil Blackwell, 1987). Sen also questions the empirical relevance of traditional welfare economics in his *Choice, Welfare and Measurement* (Cambridge, Mass.: MIT Press, 1982). For a criticism of alternative, nontraditional welfare theory, see Tyler Cowen, "What a Non-Paretian Welfare Economics Would Have to Look Like," in Don Lavoie, ed., *Economics and Hermeneutics* (New York: Routledge, 1990), 285–98.
5. CRITICAL REVIEW readers may recall the recent debate between F. M. Scherer and Dominick Armentano on the scientific and ideological status of Austrian economics as applied to industrial organization. See F. M. Scherer, "Antitrust: Ideology or Economics?" CRITICAL REVIEW 5, no. 4 (Fall 1991): 497–511; Dominick T. Armentano, "Anti-Antitrust: Ideology or Economics? Reply to Scherer," CRITICAL REVIEW 6, no. 1 (Winter 1992): 29–39; and F. M. Scherer, "Anti-Antitrust: Ideology or Economics? Rejoinder to Armentano," CRITICAL REVIEW 6, no. 1 (Winter 1992): 41–44. My paper may

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be seen as something of an extension of that debate, by offering an immanent critique of the methodological presuppositions which guided Armentano's position. It also critically extends the themes discussed some years ago in David L. Prychitko, "Ludwig Lachmann and the Farther Reaches of Austrian Economics," CRITICAL REVIEW 1, no. 3 (Summer 1987): 63–76.

6. This can be shown only under specific convexity conditions. A group or social utility function must exist which, although perhaps composed of non-quasi-concave individual utility functions, is itself a family of convex hulls that is necessarily quasi-concave. This allows the theorist to assume comparable marginal rates of substitution in consumption among all consumers. See, e.g., E. Malinvaud, *Lectures on Microeconomic Theory* (New York: American Elsevier, 1972), 96–99, 165–170.
7. Relying upon Chicago-school partial equilibrium theory (particularly with its Tight Prior assumption) gets the analyst no further. See Richard H. Fink, "General and Partial Equilibrium in Bork's Antitrust Analysis," *Contemporary Policy Issues* 3 (Winter 1984–85).
8. Not everyone agrees with Hahn. See, for example, Franklin M. Fisher, *Disequilibrium Foundations of Equilibrium Economics* (New York: Cambridge University Press, 1983), esp. ch. 2.
9. The essay first appeared in a 1956 festschrift for Ludwig von Mises, and was resurrected over 20 years later as an occasional paper. See Murray N. Rothbard, "Toward a Reconstruction of Utility and Welfare Economics," in Mary Sennholz, ed., *On Freedom and Free Enterprise* (Princeton, N.J.: Van Nostrand, 1956), republished as *Toward a Reconstruction of Utility and Welfare Economics* (New York: Center for Libertarian Studies, 1977). All references are to the 1977 version. Rothbard's welfare theory also reappears with minor revisions in *Man, Economy, and State*, vol. 2, 768–777, and *Power and Market* (Kansas City: Sheed, Andrews, and McMeel, 1970), 13–23. Rothbard recently claimed that his reconstruction of welfare theory was a creative development and advancement of Misesian economics. See his *The Present State of Austrian Economics* (Auburn, Ala.: Ludwig von Mises Institute, 1992), 7. For a spirited defense of Rothbard's general approach, see Hans-Hermann Hoppe, "Austrian Rationalism in the Age of the Decline of Positivism," in Richard M. Ebeling, ed., *Austrian Economics: Perspectives on the Past amd Prospects for the Future* (Hillsdale, Mich.: Hillsdale College Press, 1991), 59–96.
10. "Economics, or praxeology, has full and complete knowledge of its original and basic axioms. These are axioms *implicit in the very existence of human action*, and they are absolutely valid as long as human beings exist. But if the axioms of praxeology are absolutely valid for human existence, then so are the consequents which can be logically deduced from them. Hence, economics, in contrast to physics, can derive absolutely valid substantive truths about the real world by deductive logic. The axioms of physics are only hypothecated and hence subject to revision; the axioms of economics

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are already known and hence absolutely true" (Rothbard, *Toward a Reconstruction*, 3–4 [emph. in original]). This theme of the apodictic status of praxeology (pure theory) is repeated throughout Rothbard's later works. See, for example, his "In Defense of 'Extreme Apriorism,'" *Southern Economic Journal* 23 (1957): 314–20; idem, *Man, Economy, and State*, vol. 1, esp. ch. 1; idem, "Praxeology: The Method of Austrian Economics"; and "Praxeology, Value Judgements, and Public Policy," in Edwin G. Dolan, ed., *The Foundations of Modern Austrian Economics* (Kansas City: Sheed and Ward, 1976), 19–39, 89–111; idem, *Individualism and the Philosophy of the Social Sciences* (San Francisco: Cato Institute, 1979); idem, "Preface" to Ludwig von Mises, *Theory and History: An Interpretation of Social and Economic Evolution* (Washington, D.C.: The Ludwig von Mises Institute, 1985), no pagination; and idem, "The Present State," 8ff. A more recent restatement of praxeological economic theory comes from Rothbard's student, Hoppe:

> Indeed, the Austrian school represents the most ambitious of all forms of social relationalism with its unyielding contention that nonhypothetical, a priori, empirical knowledge within the field of the social sciences exists, and that it is ethics and economics (which contain this knowledge), which are analogous to logic and protophysics as the absolutely indispensable foundation for all empirical social research. Furthermore, the Austrian school alone has substantiated this contention by offering a completely developed, consistent, and all-comprehensive *positive* theory of ethics and economics.

See Hoppe, 81.

11. Rothbard, "Praxeology: The Method," 33.
12. Rothbard, *Toward a Reconstruction*, 2.
13. "The prime error here is the assumption that the preference scale remains constant over time," writes Rothbard. "There is no reason for making any such assumption. All we can say is that an action, at a specific point of time, reveals part of man's preference scale *at that time*" (Rothbard, *Toward a Reconstruction*, 5 [emph. in original]).
14. This notion of the free market runs throughout Rothbard's later works. In *Man, Economy, and State*, for example, Rothbard claims that exploitation cannot occur in the free market. Reminiscent of nineteenth-century liberalism, Rothbard goes so far as to say "on the market all is harmony" (vol. 2, 769). Of course, most free-market economists share Rothbard's view that the market is simply, and only, the total nexus of voluntary exchanges and chide critics of the actual market processes for not understanding this. See, e.g., Richard E. Wagner, "Politics, Central Banking, and Economic Order," CRITICAL REVIEW 3, nos. 3–4 (Summer-Fall 1989): 505–17, esp. 510.
15. Rothbard, *Toward a Reconstruction*, 27 (emph. in original). Cf. idem, *Man, Economy, and State*, vol. 2, 880.
16. Rothbard, *Toward a Reconstruction*, 27. Cf. idem, *Man, Economy, and State*

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vol. 2, 880–81; idem, *Power and Market*, ch. 7; and idem, "Praxeology, Value Judgements, and Public Policy."

17. This argument appears in Rothbard, *Man, Economy, and State* vol. 2, 772–77; and idem, *Power and Market*, 18–23.
18. I have in mind the discussions by Fred Hirsch, *Social Limits to Growth* (Cambridge, Mass: Harvard University Press, 1976), esp. ch. 3, and Joel Jay Kassiola, *The Death of Industrial Civilization: The Limits to Economic Growth and the Repoliticization of Advanced Industrial Society* (Albany, N.Y.: State University of New York Press, 1990), ch. 6. On the more general social influences upon tastes and preferences, see Michael S. McPherson, "Want Formation, Morality, and Some 'Interpretive' Aspects of Economic Inquiry," in Norma Haan, Robert N. Bellah, Paul Rabinow, and William M. Sullivan, eds., *Social Science as Moral Inquiry* (New York: Cambridge University Press, 1983), 96–124.
19. Melvin W. Reder, "Comment," in *Survey of Contemporary Economics*, vol. 2 (Homewood, Ill.: Irwin, 1952), 34–36.
20. Rothbard, *Toward a Reconstruction*, 27 (emph. in original).
21. Rothbard, *Power and Market*, 18.
22. Traditional neoclassical theory tries to avoid these questions by allowing only pecuniary arguments to enter the individual and social utility functions, which is admittedly unrealistic. But Austrian theory, including Rothbard's, purports to study human action in its rich and wonderful complexity, rather than arbitrarily restricting it to pecuniary and traditionally "economic" motivations. See, e.g., Ludwig von Mises, *Human Action* (Chicago: Henry Regnery, 1963), 62–64, and esp. 651–52; and Rothbard, *Man, Economy, and State*, vol. 1, 63.
23. Rothbard, "Praxeology, Value Judgements, and Public Policy," 99–100. Cf. Lionel Robbins, *An Essay on the Nature and Significance of Economic Science*, 2d ed. (London: Macmillan and Co., 1935), 141–42. Citing *Toward a Reconstruction*, Armentano accepts Rothbard's argument that the market increases ex ante social utility. For example, when considering horizontal price agreements, Armentano claims that they "always signify unambiguous evidence of benefit (utility) to the parties involved. We know that the parties to the agreement expect to benefit—else why did they make the agreement? On the other hand, we do not know if there is a loss to society as a whole, since costs are ultimately subjective and incapable of aggregation and exact measurement. Thus we could always assert that in our judgement the benefits exceed any possible costs, and not vice versa, as neoclassical analysis has consistently assumed" (Armentano, *Antitrust and Monopoly: Anatomy of a Policy Failure* [New York: John Wiley and Sons, 1982], 137–38).
24. All quotes are from Rothbard, *Toward a Reconstruction*, 29 (emph. in original). Also see idem, "Praxeology, Value Judgements, and Public Policy," 100.
25. I thank an anonymous referee for reminding me of this.

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26. Elsewhere Rothbard claims that intervention in the market is likely to create unintended consequences that the interveners eventually find undesirable. Therefore, although state officials enjoy ex ante gains when they first interfere with the market (demonstrating a preference for coercion), they will nevertheless become frustrated over time and suffer ex post utility losses: "As we analyze the *indirect* consequences of intervention . . . we shall find that, in every instance, the consequences of intervention will make the intervention look worse in the eyes of many of its original supporters. . . . *Ex post*, many of the interveners themselves will feel that they have lost rather than gained in utility" (Rothbard, *Man, Economy, and State*, vol. 2, 777; cf. idem, *Power and Market*, 23). So Rothbard would have us believe even the proponent of coercion will ultimately suffer utility losses. Of course, if the coercer loses along with the coerced, then everybody loses and the state can't increase social utility. If Rothbard is willing to count the imagined ex post utility losses of state officials, however, then he should also be willing to entertain thoughts of coerced citizens enjoying ex post utility gains (for example, when an attempted suicide fails because of intervention, the individual may be happy that his life was saved). Moreover, if Rothbard is willing to claim that the bungled projects of bureaucrats who monkey with markets unexpectedly create ex post utility losses, for the sake of consistency he should be willing to treat the foiled projects of free-market entrepreneurs similarly. After all, an entrepreneur who suffers monetary losses most probably suffers ex post utility losses, too. But Rothbard instead throws the issue out the door:

> Take, for example, the buggy manufacturer who faces a shift in public demand from buggies to automobiles. Does *he* not lose utility from the operation of the free market? We must realize, however, that we are concerned only with utilities that are *demonstrated* by the manufacturer's action. In both period 1, when consumers demanded buggies, and in period 2, when they shifted to autos, he acts so as to maximize his utility on the free market. The fact that, in retrospect, he prefers the results of period 1 may be interesting data for the historian, but is irrelevant for the economic theorist. For the manufacturer is *not* living in period 1 any more. He lives always under *present* conditions and in relation to the present value scales of his fellow men" (Rothbard, *Man, Economy, and State*, vol. 2, 770 [emph. in original]).

Were Rothbard to use the same analysis he applied to the inept entrepreneur when analyzing bureaucrats, he would have no grounds for claiming that state intervention tends to create ex post utility losses on behalf of the bureaucrats themselves. If he uses the same analysis he applied to bureaucrats when analyzing inept entrepreneurs, he has no grounds for claiming that the free market tends to maximize the ex post utility of all its participants. Perhaps fearing that the first option would weaken his criticism of

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the state while the second would undermine his defense of the market, Rothbard arbitrarily applies two different theoretical standards, and therefore violates his own claim that his praxeological theory is "a formal but universally valid science based on the existence of human action and on the logical deductions from that existence" (Rothbard, *Power and Market*, 203). As far as I can tell, Rothbard can't deduce both stories from the same set of axioms.

27. Rothbard, *Man, Economy, and State*, vol. 1, 275.
28. See idem, "Praxeology: The Method"; and idem, *Individualism and the Philosophy of the Social Sciences*, esp. 19–22, 31–43.
29. Cordato's overview of the earlier Austrian school (ch. 1) and his criticisms of Coase (ch. 5) are quite informative, but unfortunately I cannot discuss every aspect of Cordato's book. My inquiry is more narrow: I shall critically focus upon the foundations and claims behind Cordato's reformulation of Austrian welfare economics.
30. Cordato's claim is questionable. No matter how badly argued, Rothbard *thinks* he examines ex post utility losses—at least for bureaucrats.
31. Cordato says that (1) is the "most common criticism," (2) is "readily apparent" once (1) is recognized, (3) and (4) are "even more damaging criticisms," while (5) is "another fundamental problem."
32. I would not expect Cordato to demonstrate this himself if he were simply reiterating Kirzner's position. That would be like asking him to reinvent the wheel. My point is that Cordato's "catallactic efficiency" concept intends to depart from Kirzner's argument that the market is a strictly coordinating process, but it relies almost fully on Kirzner's *knowledge* claims, the very claims that point toward the market as a fundamentally coordinating process. Kirzner has been very careful to discuss the kind of knowledge necessary for the market to have coordinating properties (see his "Hayek, Knowledge, and Market Processes" and "Knowing about Knowledge: A Subjectivist View of the Role of Information" in idem, *Perception, Opportunity, and Profit: Studies in the Theory of Entrepreneurship* [Chicago: University of Chicago Press, 1979], chs. 2, 9; and idem, *The Meaning of Market Process: Essays in the Development of Modern Austrian Economics* [New York: Routledge, 1992], esp. chs. 8, 9, 10).
33. Cf. Armentano, *Antitrust and Monopoly*, 275. Armentano writes, "Social efficiency, if the expression has any meaning whatever, is to be associated with a society that allows full scope for free and voluntary exchange agreements. Social arrangements are efficient if they provide the widest opportunity for private plan fulfillment and private plan coordination. A free society is both the necessary and the sufficient condition for efficient action and efficient resource allocation. . . . The efficient accomplishment of ends in a social context requires that particular planned activity dovetail or coordinate with the planned activity of other market participants" (29). Here Armentano is thoroughly Kirznerian in that social efficiency is tied to the market's tendency to equilibrate (to tend toward a complete coordi-

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nation of individual plans). In his foreword to the Cordato book Armentano embraces, without hesitation, Cordato's concept of catallactic efficiency, and considers price agreements as an example of increased social efficiency in Cordato's sense of the term. See his "Foreword" in Cordato, *Welfare Economics*, ix–xiii. It seems that Cordato's "open-endedness" is not really of a loosely Schumpeterian, creatively destructive variety after all. In the end, Cordato's story has strictly Kirznerian results.

34. See, e.g., Jack High, "Equilibration and Disequilibration in the Market Process," in Israel M. Kirzner, ed., *Subjectivism, Intelligibility and Economic Understanding* (New York: New York University Press, 1986), 111–21; and idem, *Maximizing, Action, and Market Adjustment: An Inquiry into the Theory of Economic Disequilibrium* (Munich: Philosophia Verlag, 1990), 70–82; Gerald P. O'Driscoll and Mario J. Rizzo, *The Economics of Time and Ignorance* (New York: Basil Blackwell, 1985), ch. 5; Karen I. Vaughn, "The Problem of Order in Austrian Economics: Kirzner vs. Lachmann," *Review of Political Economy* 4, no. 3; James Buchanan and Viktor Vanberg, "The Market as a Creative Process," *Economics and Philosophy* 7 (1991): 167–86; and Peter Boettke, Steven Horwitz, and David L. Prychitko, "Beyond Equilibrium Economics: Reflections on the Uniqueness of the Austrian Tradition," *Market Process* 4, no. 2 (Fall 1986) (reprinted in Peter J. Boettke and David L. Prychitko, eds., *The Market Process: Essays on Contemporary Austrian Economics* [Aldershot, U.K: Edward Elgar, 1994]).

35. See, e.g., Kenneth Boulding, *Evolutionary Economics* (Beverly Hills, Calif.: Sage, 1981); Paul Davidson, "The Economics of Ignorance or Ignorance of Economics?" CRITICAL REVIEW 3, nos. 3–4 (Summer-Fall 1989): 467–87; Ludwig M. Lachmann, "From Mises to Shackle: An Essay on Austrian Economics and the Kaleidic Society," *Journal of Economic Literature* 14 (March 1976): 54–62; Warren J. Samuels, "In (Limited but Affirmative) Defense of Nihilism," *Review of Political Economy* 5, no. 2 (1993): 236–44; G.L.S. Shackle, *Epistemics and Economics: A Critique of Economic Doctrines* (New Brunswick, N.J.: Transaction, 1992).

36. "To the extent that such decisions are made through the state apparatus, economics can help clarify some of the opportunity costs associated with transferring additional resources from the private to the public sector, and some of the benefits that might accrue for the market process as a result of enhanced property rights enforcement" (Cordato, 86). Which costs are those, the objective ones?

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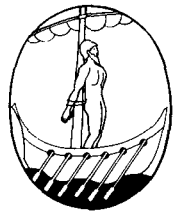

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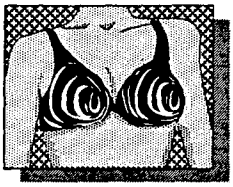

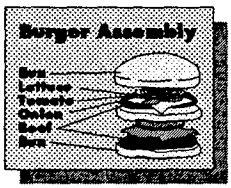

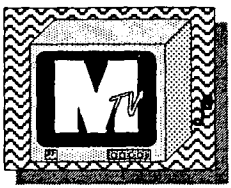

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